The McGraw·Hill Companies
NOVEMBER 2, 2009 | BUSINESSWEEK.COM

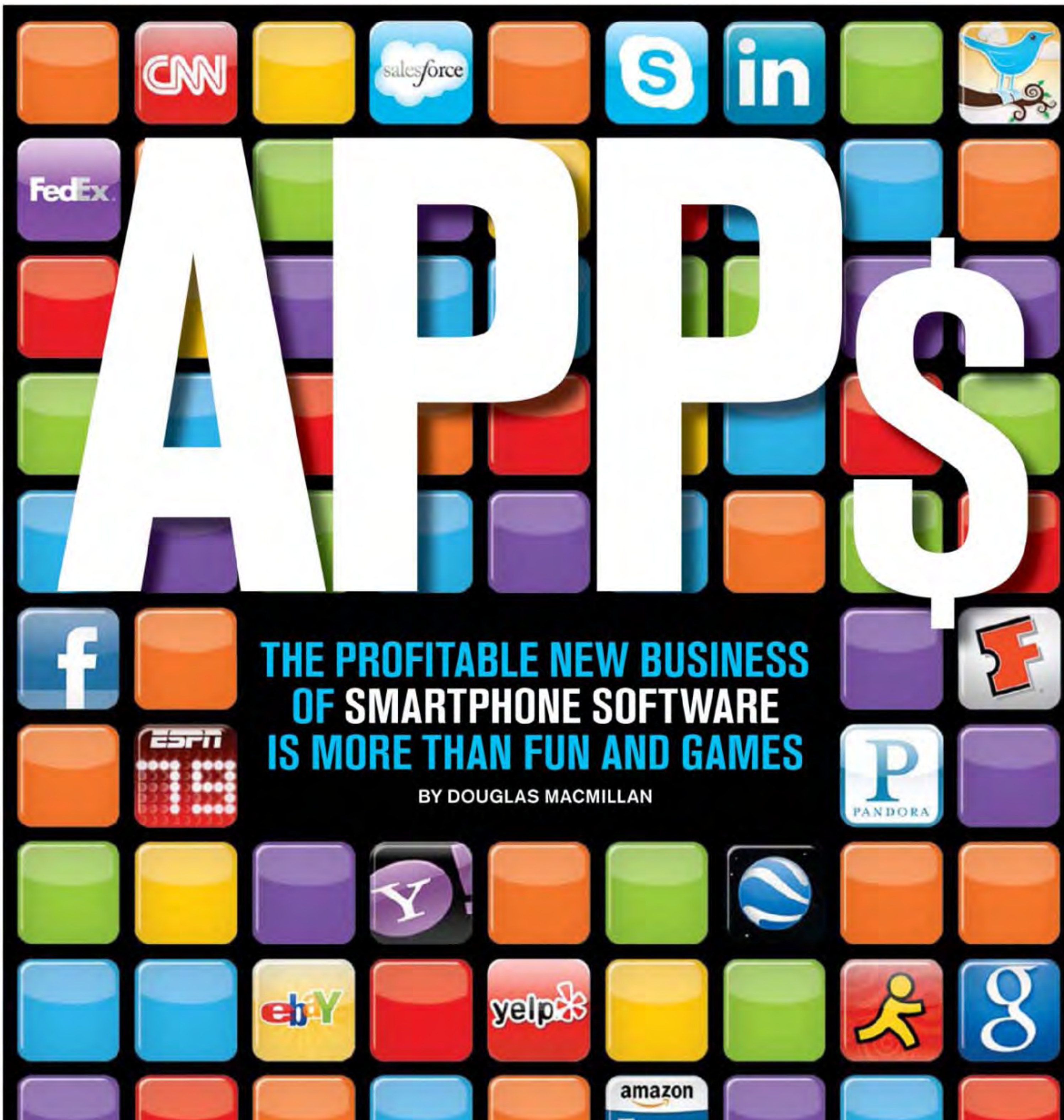
CHINA'S ECONOMY BEHIND ALL THE HYPE

BusinessWeek

APP$

THE PROFITABLE NEW BUSINESS OF SMARTPHONE SOFTWARE IS MORE THAN FUN AND GAMES

BY DOUGLAS MACMILLAN





Copyright © 2009 Infor. Infor and the Infor design are trademarks of Infor. Do not use or reproduce without prior written approval.



WHO SAYS BIG ERP CAN'T CUSTOMIZE ITS PRODUCTS TO FIT YOUR BUSINESS?

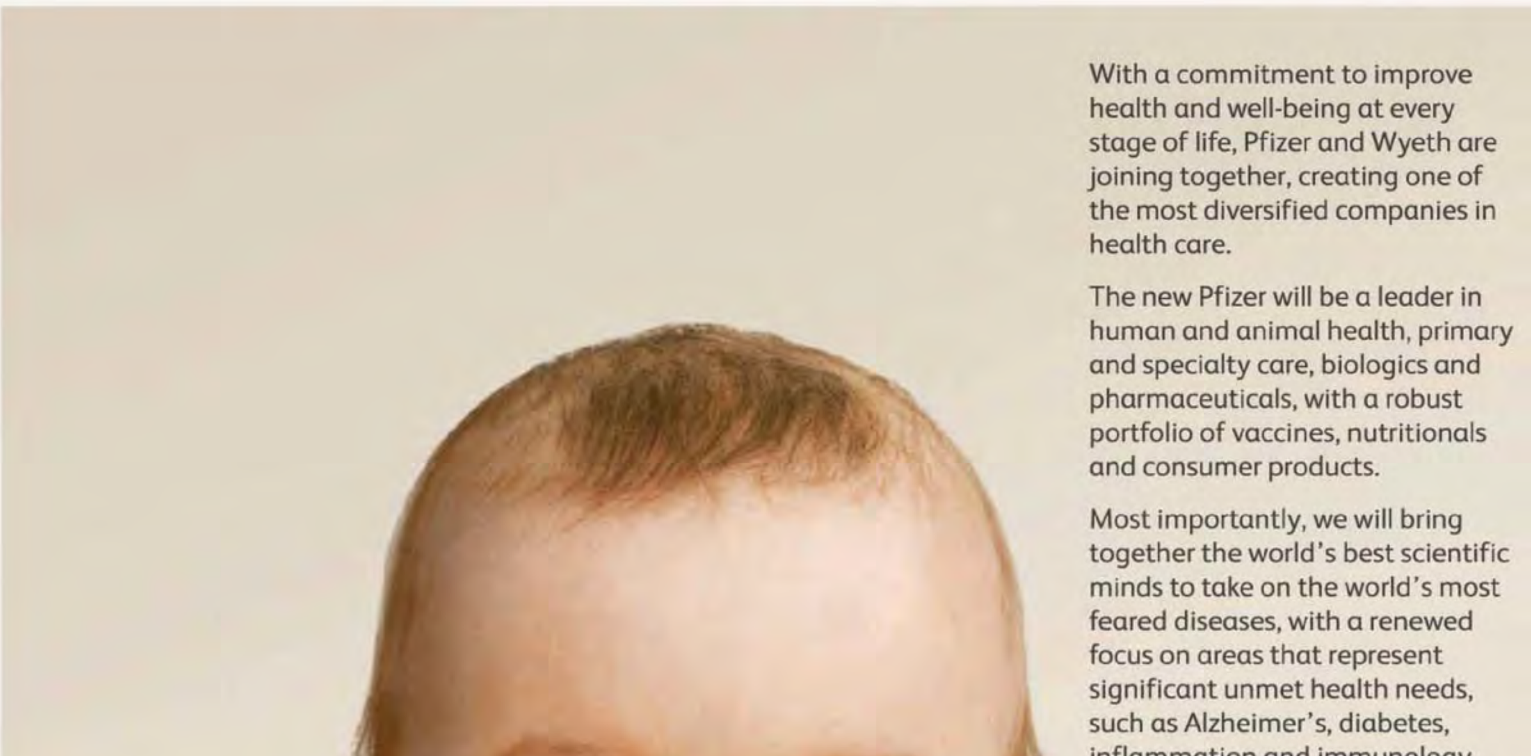
At Infor, each and every one of our products comes with business-specific functionality. Making them easier to buy, easier to deploy, and easier to manage. It's the kind of thinking that's made us the business software choice for 70,000 customers around the world. But not just another choice, a better choice.

DOWN WITH BIGERP.com

THERE IS A BETTER WAY.

INFOR™

WORKING TO FILL YEARS AND YEARS



PFIZER AND WYETH ARE NOW ONE, WORKING

LIVES WITH MORE WITH MORE LIFE.



Copyright © 2009 Pfizer Inc. All rights reserved. Wyeth is now a part of Pfizer. The merger of local Wyeth and Pfizer entities may be pending in various jurisdictions and is subject to completion of various local legal and regulatory obligations.

TOGETHER FOR A HEALTHIER WORLD.

SIMPLICITY IS POWER

The power of a virtualized enterprise.



Enterprise computing wrapped around your finger. Virtualization gives you the power of one. One instance of each desktop OS. One copy of each application. One image of each server workload. Centrally managed and assembled dynamically at runtime. Delivered as a high-definition, personalized, on-demand service. That's the power of virtualization. The power to turn your datacenter into a delivery center. Citrix virtualization and networking solutions.

For the desktop, the datacenter, the cloud.

It's enterprise computing, simplified.

Simplicity is power. Citrix.

CITRIX®

Citrix.com/SimplicityIsPower

© 2009 Citrix Systems, Inc. All rights reserved.



Big spending: China's Baling River Bridge

RYAN PYLE/CORBIS; COVER DESIGN BY RONALD PLYMAN/BW; ILLUSTRATION BY DAVID RUDES/BW

IN DEPTH

CHINA: BEHIND THE HYPE

036 | The mainland's rapid rebound seems to vindicate Beijing's model of state-led capitalism. But while its growth seems unstoppable, China's economy is likely to remain unbalanced and unstable, critics say. |BW|

INSIDE THE APP ECONOMY

044 | Overnight, those bite-size programs people load onto their mobile phones and download from the Net have exploded into a billion-dollar industry. Meet the heavy hitters in apps. |BW|

DEBT WATCH IN DUBAI

050 | In a decade of frenzied building, the emirate transformed itself into a glittering jewel and the region's premier business hub. But now its collection of agencies and state-backed companies owe 126% of GDP. |BW|





A SKEPTIC'S GUIDE TO EARNINGS

Troubled companies, fearful of losing their credit and other lifelines, are using a host of techniques to disguise their true financial health. The gimmicks are underscoring the tenuous nature of the earnings recovery. | BW | **PAGE 026**

GEITHNER ON THE ECONOMY

Treasury Secretary Tim Geithner talks to Maria Bartiromo about fueling a recovery, easing the credit crisis, and prospects for growth in the U.S. economy. | BW | **PAGE 019**

008 THE BUSINESS WEEK

008 **EXECUTIVE SUMMARY** Apple's golden quarter; earnings perk; more

012 **BUSINESS OUTLOOK** Jim Cooper sees a surprising third-quarter pickup

014 **NUMBERS** Americans aren't loosening their purse strings

016 **BTW** Unlikely mall stores; the year in bankruptcies; stareworthy stairs

019 **FACETIME**

022 NEW BUSINESS

022 **HEALTH CARE: WHO WILL PAY?** Insurers and taxpayers are likely to bear the brunt of Obama's overhaul

025 **INSIDE TRADING** The SEC mounts a new offensive against criminals

026 **A SKEPTIC'S GUIDE TO EARNINGS**

028 **WHAT'S HOLDING BACK TECH** Parts shortages bedevil gizmo makers

030 **THE ECONOMY** How real is the capacity glut?

032 **PIRACY** The Chinese are beginning to take the problem seriously

034 **NISSAN** Overextended in the U.S.?

054 WHAT'S NEXT

054 **GREEN GIANTS** Former Silicon Valley colleagues John Doerr and Vinod Khosla go head-to-head in clean tech

056 **TOUGH LOVE, LOWER COSTS** A bold plan to treat the chronically ill

058 **EMISSION TARIFFS** An effort to level the playing field for clean U.S. manufacturers

060 **SMALL BIZ** The credit spigot has increased from a drop to a trickle

062 **EUROPE INC.** Michelin and other companies are using U.S.-style tactics to fight price-fixing

063 **CBS's BRAVE OLD WORLD** The network is pulling in a graying but paying audience

064 **INDIA** Airlines are cutting posh meals and business-class seats

065 **CORPORATE SURVIVORS** Why the laid off are sometimes better off

067 PERSONAL BUSINESS

067 **MONEY REPORT** The dollar and the market; munis hit a wall; Valmont

068 **HOW TO PLAY IT** Betting on China's growth machine

069 **SAVINGS** Should you convert your 401(k) to a Roth?

070 **LIFE MANAGEMENT** How women handle success: A roundtable talk led by Marcus Buckingham

072 **INSIDE WALL STREET**

074 BUSINESS VIEWS

074 **BOOKS** Levitt and Dubner: *SuperFreakonomics*

076 **TECH & YOU** Steve Wildstrom keys into RIM's new Storm phone

078 **FEEDBACK** The "Lost Generation" cover story reopened an old debate among readers

080 **OUTSIDE SHOT** Companies should reveal their campaign spending

078 **CORRECTIONS & CLARIFICATIONS**

079 **COMPANY INDEX**

Jack and Suzy Welch are off while Jack recovers from a back infection.

ILLUSTRATION BY PAUL BLOW; PHOTOGRAPH BY XINHUA/WPN



The General Management Program is where accomplished managers from across the world gain the business expertise to master newly expanded responsibilities and prepare for the challenges that lie ahead. Are you ready to take the next step? Email **gmp_info@hbs.edu** to receive more detailed information. Global Perspectives. Tangible Business Results.

HARVARD BUSINESS SCHOOL

EXECUTIVE EDUCATION

THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD



Apple's Fifth Avenue store: The company's profits rose 47% in the past quarter

LUCAS JACKSON/REUTERS

ECONOMICS & POLICY

APPLE'S GOLDEN QUARTER

In a closely watched earnings season, Apple could hardly have delivered better news to investors eager for evidence of real consumer demand to justify the recent bull market. The company topped forecasts with a 47% profit leap and 12% revenue growth in the quarter ended Sept. 30, thanks to record sales of both **Macs** and **iPhones.** Better yet, **COO Tim Cook** says the company could have sold far more had it had more inventory in place. That sent Apple shares to an all-time high of 205 on Oct. 21 and left analysts scrambling to lift their target prices to as much as 280. And Apple was hardly alone in the good-tidings department. Other tech outfits such as **Google, SanDisk,** and **Yahoo!** blew past estimates, as did banks including **U.S. Bancorp** and **Morgan Stanley,** and the earnings picture generally looked sunnier than predicted. One big exception: **Boeing,** which lost $1.6 billion.

|BW| PAGE 026 "Magic Tricks on the Corporate Books"

MORE SIGNS OF RECOVERY

That low hum you hear out the window could be the sound of assembly lines starting up again. The Fed said on Oct. 16 that industrial output jumped 0.7% in September, and the 0.8% increase reported in August was revised up to a smart 1.2% gain. Aside from automakers, which enjoyed an 8.1% boost in September, manufacturing rose 0.4%. Meanwhile, inflation stayed cool as consumer prices ticked up 0.2% after August's 0.4% gain, thanks to lower food prices and slower growth in energy costs. Overall producer prices fell 0.6% in September, sending them down 4.8% on a yearly basis—though if you leave out the volatile costs of food and energy, the monthly drop came to just

-0.6%

Change in the U.S. producer price index in September

Data: Labor Dept.

0.1%, and wholesale prices rose 1.8% for the year.
| BW | PAGE 030 "Beware the Bottlenecks"

EMBATTLED INSURERS

Are health insurance companies covered for shooting themselves in the foot? They have been making nice with the White House and Congress for months in order to ensure that any reform bill would give them access to some 30 million uninsured Americans without demanding too much in return. But the industry released two high-profile reports on Oct. 11 and 14 attacking the **Senate Finance Committee** version. **President Barack Obama** quickly returned fire in his weekly radio address, charging insurers with lying. The **Senate Judiciary Committee** followed up on Oct. 21 with proposed legislation that would end a 60-year-old exemption of health insurers from federal antitrust laws.
| BW | PAGE 022 "Who Picks Up the Tab for Health Reform"

FINANCE

GALLEON'S DOWNFALL

Profiting from insider info has plagued stock markets from time immemorial. But the bust of **Raj Rajaratnam,** billionaire founder of hedge fund **Galleon Group,** for allegedly trafficking in ill-gotten information, harks back to what might be called the Golden Age of insider trading, when **Ivan Boesky** stalked the Street in the 1980s. Rajaratnam and five others, including executives at **IBM, Intel,** and **McKinsey,** were arrested on Oct. 16. Four were charged with securities fraud and conspiracy, and two with conspiracy. The **SEC** also filed civil charges of insider trading against the six, and on Oct. 21, Galleon said that it will shut down its hedge funds.
| BW | PAGE 025 "The SEC: To Catch a Cheat"

CIT: ICAHN WEIGHS IN

Add **Carl Icahn** to the cast of the **CIT Group** soap opera. The billionaire on Oct. 19 inveighed against the commercial lender's debt-restructuring plan, declaring it "incompetent and unconscionable" in a letter to the board. Under the deal, CIT shortened the maturity of new notes by six months, raised the amount of equity slated for holders of junior debt, and added long-term debtholders to the mix of creditors who can participate. It also forced bondholders to accept a prepackaged bankruptcy plan. Icahn, who calls himself CIT's largest shareholder, is grumpy that the deal offers large unsecured bondholders the chance to buy $6 billion in secured loans at below-market prices.



Icahn jumped into the CIT mess with a loan offer

TIM BOYLE/BLOOMBERG NEWS

Welcome to 4G. Laptops, prepare for liftoff. *Get ready, America. The first and only wireless 4G network from a national carrier is arriving. Get amazing 3G speeds today and record-breaking 4G speeds tomorrow. Welcome to the Now Network.™ 1-800-SPRINT-1 sprint.com/4G*

Free
Sprint 3G/4G USB Modem U300
For your business account. Requires an eligible upgrade (or new-line activation) and a two-year Agreement.

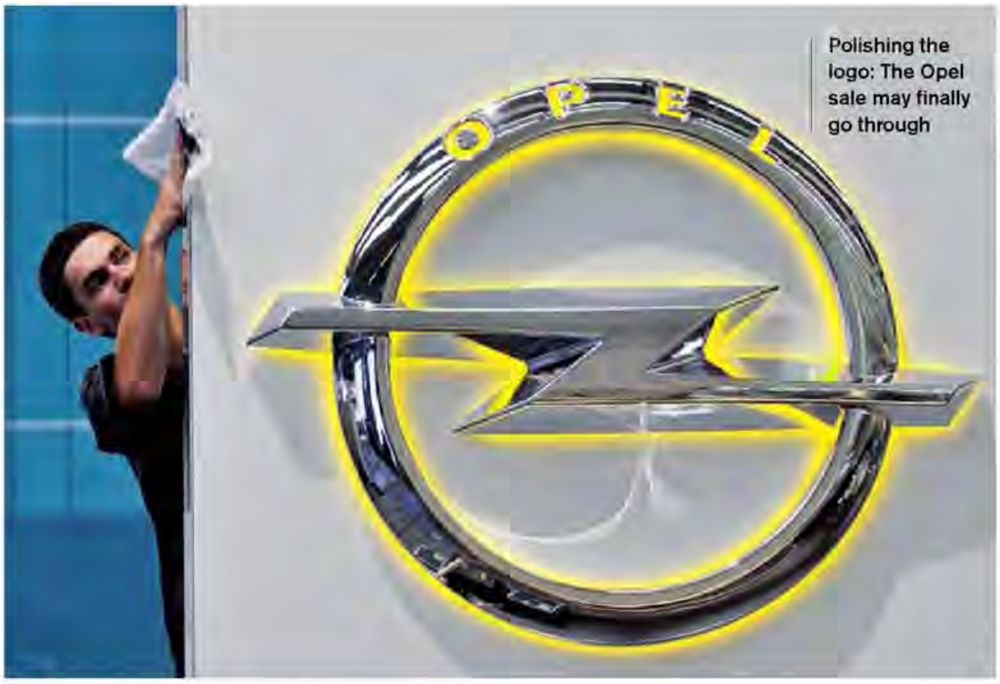
Sprint



Get speeds up to 10x faster than 3G. It's faster than any wireless service from AT&T or Verizon.

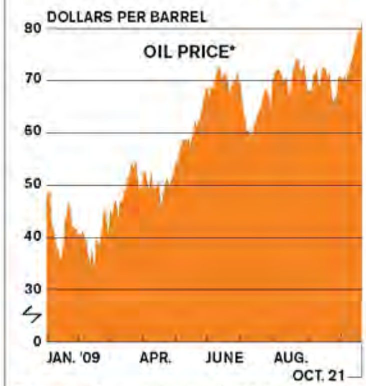
Average Download Speeds: 4G (3–6 Mbps); 3G (600 Kbps–1.7 Mbps). **"Up to 10x Faster" Claim:** Based on a comparison of lowest 3G speeds to highest 4G speeds (average only). Actual speeds may vary.

May require up to a $36 activation fee/line, credit approval and deposit. Up to a $200 early termination fee/line applies. **Mobile Broadband Card Offer:** Offer ends 1/1/10 or while supplies last. **Business Account:** Available to corporate-liable customers only. Taxes and service charges excluded. No cash back. Requires activation at the time of purchase. A Sprint Mobile Broadband Card data plan is required. **Upgrade:** Existing customers in good standing with service on the same device for more than 22 consecutive months currently activated on a service plan of $39.99 or higher may be eligible. See in-store rebate form or sprint.com/upgrade for details. **Other Terms:** Coverage not available everywhere. 4G is currently available in limited areas and on select devices; check sprint.com/4G for Sprint 4G coverage/device info. The 3G Sprint Mobile Broadband Network reaches over 253 million people. Offers not available in all markets/retail locations or for all phones/networks. Pricing, offer terms, fees and features may vary for existing customers not eligible for upgrade. Other restrictions apply. See store or sprint.com for details. ©2009 Sprint.



Polishing the logo: The Opel sale may finally go through

MOVING HIGHER



*Based on Nymex one-month oil futures contract
Data: Bloomberg.

As an alternative he offered to loan the company $6 billion for a much smaller fee. CIT said it "remains open to securing financing on the most beneficial terms."

PAY CZAR CRACKDOWN

Nearly everyone but bankers is complaining about bankers' pay, and now various parties appear to be doing something about it. On Oct. 21, *The New York Times* reported that **Kenneth Feinberg,** special master at the **Treasury** in charge of compensation issues, will issue an order "in the next few days" slashing the pay of top brass at U.S. companies that received the biggest bailouts. Firms will have to cut cash payouts to their 25 best-paid executives by an average of 90% from last year. For all executives, total pay including bonuses will sink by 50%. Meanwhile, Swiss bank **Credit Suisse** on Oct. 20 announced a new bonus scheme for top employees that would link compensation more closely to earnings and the stock price—and discourage taking wild risks to boost short-term returns.

STRATEGY

BANAMEX BROUHAHA

If the Mexican Senate has its way, **Citigroup** may have to say goodbye to one of its richest units: Banamex, Mexico's second-largest bank, which kicks in some 15% of Citi's worldwide profits. Concerned that the U.S. Treasury's 34% stake in the troubled American bank violates a constitutional ban on foreign government ownership of Mexican banks, a Senate committee agreed on Oct. 15 to ask the Supreme Court for a ruling, which could take months to materialize. Citi paid $12.5 billion for Banamex in 2002, and analysts figure it might fetch $15 billion to $20 billion now.

GREEN LIGHT FOR OPEL?

General Motors may have passed the last stop sign in its drive to sell its sputtering European Opel unit. GM on Sept. 10 agreed to offload 55% of Opel to Canadian auto-parts maker **Magna International** and its partner, Russia's **Sberbank.** But at the last moment the **European Union** questioned whether the German government strong-armed GM into picking Magna. After talks between Berlin, the EU, and Opel's labor union, the regulators backed off, so the deal may actually close this week.

Attorney General Brown sued State Street for alleged overcharges to pension funds



JERRY BROWN'S CRUSADE

Back in the day, **Jerry Brown** was known as "Governor Moonbeam" for his New-Age ways, but he was always hard-nosed when the occasion required. On Oct. 20, in his present incarnation as **California Attorney General,** he said he had filed suit against **State Street Bank & Trust** for allegedly overcharging the state's two big pension funds, **CalPERS** and **CalSTRS,** in foreign currency transactions. Brown claims that for eight years the bank charged the funds the highest exchange rate on the day of a trade rather than the market rate at the time trades were done. Brown is asking for damages equal to three times the $56 million in supposedly fraudulent charges. A spokeswoman for State Street said the bank denies the allegations and will defend itself against any litigation.

(FROM TOP) BORIS ROESSLER/EPA/CORBIS; JEFF CHIU/AP PHOTO



Lotus knows that special someone you've been looking for.

Connections makes it easy to access colleagues with a range of skills and expertise. So you can organize your work group more efficiently and more effectively.

Smarter software for a Smarter Planet.

lotusknows.com

IBM, the IBM logo, Lotus, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2009.



A SURPRISING THIRD-QUARTER PICKUP

GDP is expected to show healthy growth—and a broad rebound in demand is a key reason. That, plus exceptionally lean inventories, points to a continued upturn well into 2010

With most of the crucial data needed to estimate third-quarter economic growth now in hand, economists are coming up with a result considerably different from what they expected only a month or two ago. Not only is the projected gain in real gross domestic product stronger, but the composition of growth is also tilted much more toward a broad pickup in demand and away from output gains resulting from businesses adjusting their inventory levels. That mix is much more favorable for continued growth.

The fear had been that the economy was embarking on a demandless recovery. That is, real GDP would get a boost in the second half solely because businesses had slashed their output in the first half far faster than demand was falling. Even if overall spending only stopped declining, companies would still be short of inventories, causing additional ordering that would temporarily lift output. But without new growth in demand, ordering would fall off once inventories were back in alignment, and the economy would stall.

3.8%

Third-quarter annual rate of increase in factory output minus autos, a 3½-year high

Data: Federal Reserve

The report on third-quarter GDP, to be released on Oct. 29, will help to allay those fears. The median forecast of 18 economists surveyed by Bloomberg expects a gain of 3.1%, the strongest in two years. Based on available monthly data, some two-thirds of that advance will come from increased spending. At the same time, businesses continued to liquidate their inventories at a rapid rate, probably helped by the sudden turn toward stronger demand. The combination of overly thin inventories and increased spending is a classic combination that will propel economic growth well into 2010.

The pickup in demand last quarter was widespread. The GDP data are expected to show that consumer spending rose at about a 3% annual rate, which would be the best showing in 2½ years. And it wasn't just cash for clunkers. The strength in nonauto retail sales in August and September suggests that more than half of the advance came from outside the boost to auto sales.

Plus, businesses have pared their outlays for equipment and software so deeply that some catch-up spending is necessary. Increased outlays by homebuilders also added to economic growth—the first contribution in 3½ years. Government surely gave a dollop of support, and both exports and imports rose strongly, showing solid demand both at home and abroad.

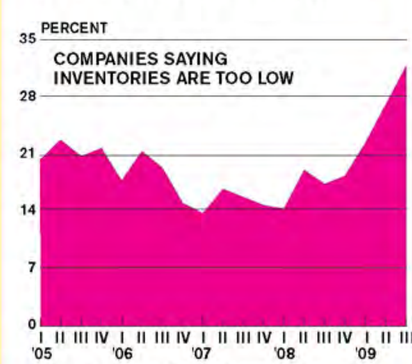
Last quarter's bounce in demand, coming after a record inventory liquidation in the second quarter and another large drawdown in the third, means businesses now have even more incentive to boost output in order to bring inventories into better balance with sales. Many economists believe inventory realignment by itself could add some two percentage points to GDP growth in both this quarter and next.

For a lasting recovery, though, the coming gains in GDP will have to create jobs that fuel income growth and keep consumers spending. That outcome will depend partly on how businesses achieve their increased production. In the third quarter, companies relied on a huge productivity gain of nearly 6%, with GDP rising some 3% and hours worked falling about 3% as payrolls declined further.

But productivity growth at that unusually high rate is hard to maintain. It eventually strains existing employees and facilities, and businesses have to add workers and equipment. Job gains may not be far off, if only because businesses have been overly aggressive in purging payrolls. Including the Labor Dept.'s latest benchmark revisions, the level of private-sector employment is back to where it was a decade ago. As GDP picks up, current payroll levels should quickly prove to be unsustainably low.

The broader message from the upcoming third-quarter GDP report will be that financial-market healing is promoting economic healing. The data will not completely calm fears of a double dip, but they will show that the time-honored business cycle forces that drive recoveries are falling into place. |BW|

THIN STOCKPILES WILL HELP POWER THE RECOVERY



Data: Institute for Supply Management, IHS Global Insight

BRAD TRENT; CHART BY RAY VELLA/BW



One global insurance program for your expanding business. Even for places you've never been.

Zurich HelpPoint is here when you need more than just insurance. So we offer the Zurich Multinational Insurance Proposition (MIP)*. It helps you keep global insurance programs compliant when you expand your business to a new market and expose yourself to new risks. The strength of Zurich MIP lies in a transparent and thorough set of solutions for writing and maintaining global insurance programs in over 170 countries. Our game-changing solution can help you sleep better at night, no matter the time zone. For more details about *Zurich HelpPoint*, visit www.zurich.com

Here to help your world.

ZURICH®

Because change happenz℠

In the United States, coverages are underwritten by member companies of Zurich in North America, including Zurich American Insurance Company. Certain coverages not available in all states. Some coverages may be written on a non-admitted basis through licensed surplus lines brokers. Risk engineering services are provided by Zurich Services Corporation. *patent pending.

30%
of customers deliver the majority of a company's profits.

The next
50%
add nothing.

How do you make the most of the remaining
20%?

Foresight to drive profits and value.

This is Analytics.

Free white paper
www.sas.com/numbers

SAS® Business Analytics

sas
THE POWER TO KNOW.

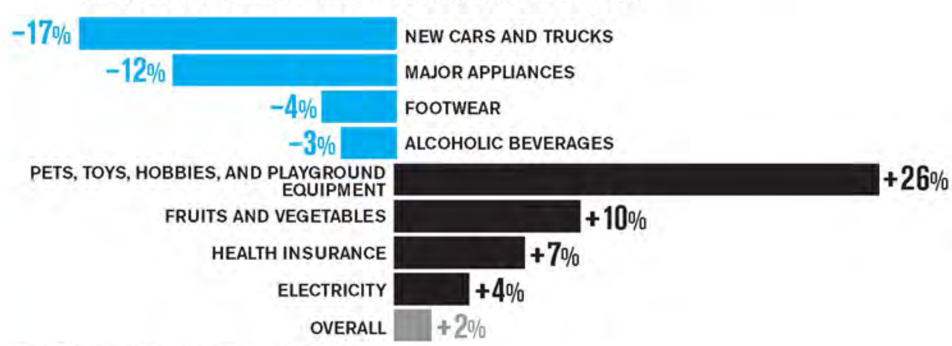
NUMBERS

AMERICANS AREN'T LOOSENING THEIR PURSE STRINGS MUCH

By Tara Kalwarski/Charts by Laurel Daunis-Allen

New data from the Labor Dept. show that after ramping up their spending by an average 5% a year during 2003-07, Americans slowed the pace to 2% in 2008. As the holidays approach, outlays may remain depressed, because household debt levels are still high.

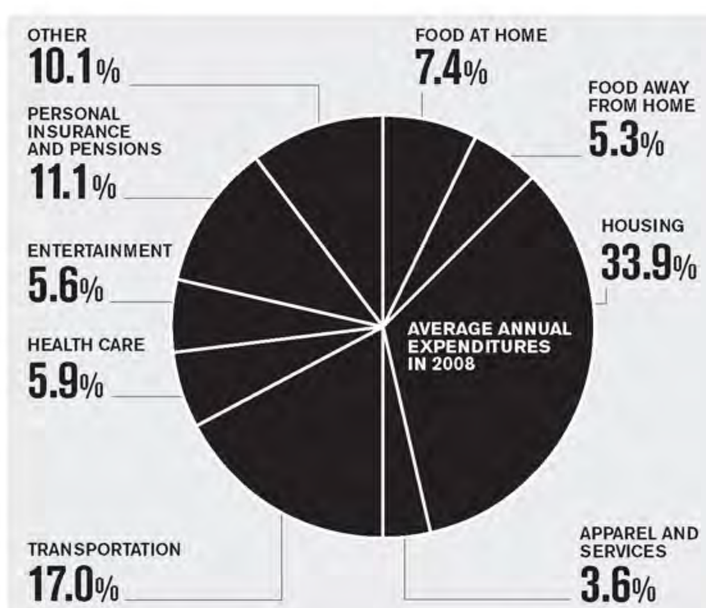
Fewer Big-Ticket Items: Overall, Americans spent more in 2008 than in 2007. But some categories saw big increases—and others suffered drops.



Data: Bureau of Labor Statistics *As of 2008

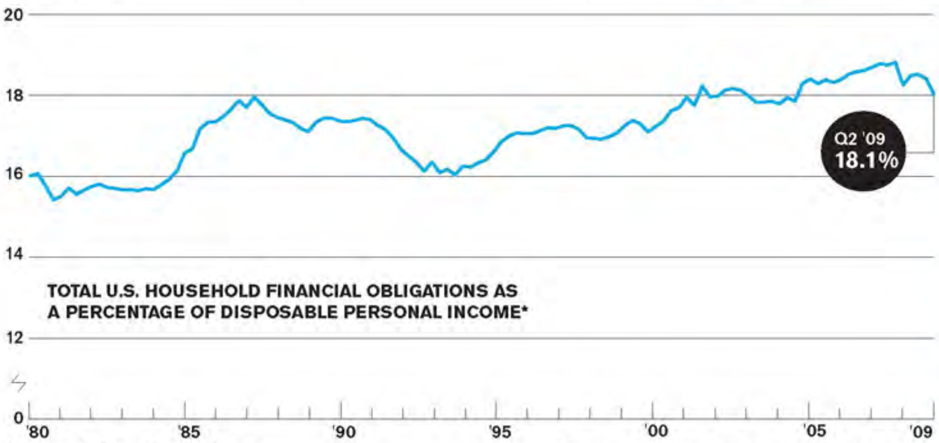
THE RICH GET FRUGAL

Housing remains Americans' biggest outlay. High-income families pulled back on spending more than the overall average, especially on clothing.



Data: Bureau of Labor Statistics *Income levels are pretax

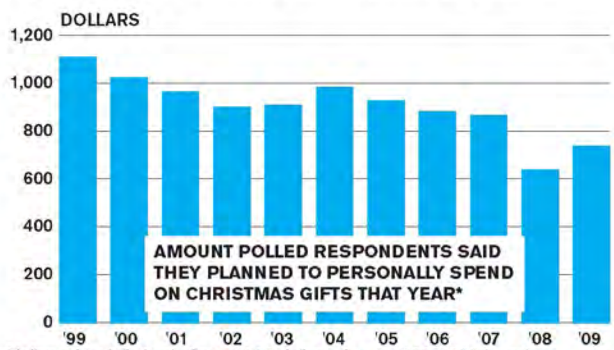
Less Pocket Money: Because fixed household expenses like mortgage and car payments remain high, discretionary spending may remain weak.



Data: Wells Fargo, Federal Reserve

*Includes all debt payments (principal and interest)

Gift Giving: Consumers expect to spend more in 2009 than '08 but less than in previous years.



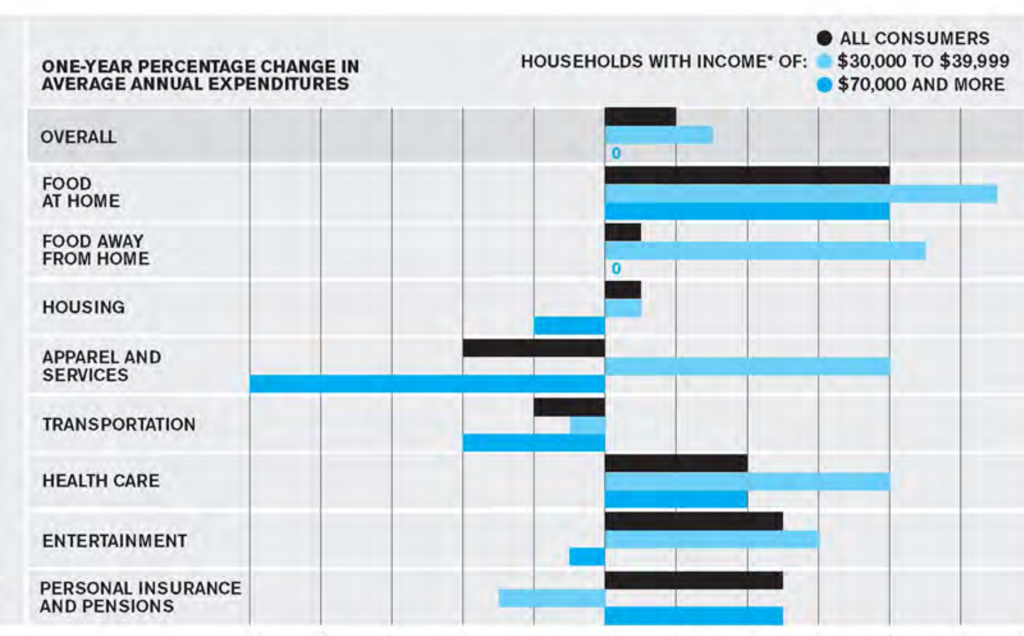
*Adjusted for inflation in Sept. 2009 dollars; data for 1999-2008 are from surveys conducted closest to Christmas

Data: Gallup, Bureau of Labor Statistics

49%

Consumers who say they used most of their 2008 economic stimulus rebate to pay off debt; 30% spent it, and 18% saved it.

Data: Bureau of Labor Statistics



91%
of the top 100 on the 2008 FORTUNE Global 500® use SAS – and that puts you in good company.

33
years of growth and stability as a privately held software company means we focus on you… not the next rumored merger.

22%
of revenue devoted annually to R&D is an investment in your future.

Foresight to thrive in an economic downturn.

This is Analytics.

Free white paper
www.sas.com/numbers

SAS® Business Analytics

sas
THE POWER TO KNOW.

© 2009 SAS Institute Inc. All rights reserved. 368606US.0309

BTW

EDITED BY DEBORAH STEAD



LOW RENTS AND WEIRD 'STORES' AT THE MALL

Shoppers have long been able to grab lunch, get a haircut, or catch a movie at the mall. But the recession's high commercial vacancy rates are bringing in unconventional tenants that offer more unusual fare.

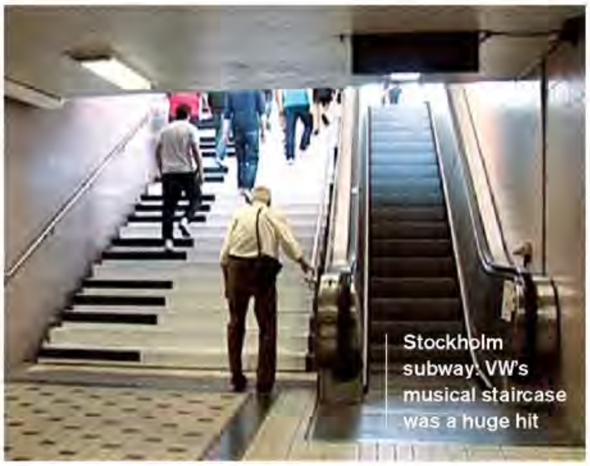
While the outdated Crestwood Court mall in St. Louis awaits a renovation, it has filled empty stores with nonprofit arts groups that pay rents of just $50 to $100 a month. The Genesee Valley Center in Flint, Mich., now houses a branch of the for-profit University of Phoenix. And at the Altamonte Mall in Altamonte Springs, Fla., a tattoo parlor has replaced the former tenant—a skateboard apparel shop. "With national tenants scaling back stores, we have an opportunity for smaller mom-and-pop businesses," says Chris Molho, an assistant general manager at Altamonte. "We're trying to find new ways to bring customers to the mall."

They need to: According to commercial real estate research firm Reis, mall vacancy rates are at record highs. For the third quarter of 2009, they rose to 8.6% at enclosed malls, the highest since the firm began keeping records in 2000. Empty retail space at open-air strip malls rose to 10.3%, the highest rate since 1992.

Reis retail sector analyst Eric Mingione says the nontraditional tenants filling the vacancies include churches, schools, and small retailers that were "once priced out" of mall space. (Also more prevalent this holiday season: pop-up stores. Toys "R" Us is opening 80 of these temporary outlets in malls and shopping centers.)

Not all malls are making creative use of vacant shops, says Greg Maloney, CEO of the retail practice at commercial real estate firm Jones Lang LaSalle. Maloney says the rise in nonprofit and mom-and-pop tenants is mostly in "C" and "D" grade malls, those with the lowest sales per square foot. Such nontraditional tenants pay less, he says, but often agree to restrictive terms, such as giving management the right to terminate if a better-known retail tenant surfaces. If current economic trends continue, Maloney says, malls could return to what has worked for them in the past: ice hockey rinks, car dealerships, and grocery stores. "We used to have them in the '60s and '70s, but we pulled them all out," he says. "Now we're looking at them again." *–Jena McGregor*

ILLUSTRATON BY RICHARD MIA



Stockholm subway: VW's musical staircase was a huge hit

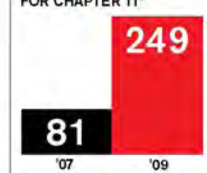
A STAIRWAY TO MARKETING HEAVEN

Behavioral economics meets viral marketing: For a few days in August, Volkswagen Sweden anonymously put a giant, working piano keyboard on a stairway in a Stockholm subway station. The idea was to make the healthier option of taking the stairs more fun than using the escalator. The experiment's success—stair traffic rose 66% as commuters glissando'd up and down—is captured in a video that has had more than 2 million hits on YouTube. The video also appears on a new Web site, Thefuntheory.com, which reveals Volkswagen's role in the stunt. Devised by ad shop DDB Stockholm, the Fun Theory campaign will next feature Web ads that "link the projects to our environmentally friendly cars," says Marcus Thomasfolk, VW Sweden's head of communications. The message: Responsible behavior doesn't have to be dull. Lars Axelsson, who runs the VW account at DDB Stockholm, wouldn't reveal the cost of the viral campaign but said given the attention it has already received "it's more than worth every penny." *–Mark Scott in London*

BANKRUPTCIES: 2009 IS ALREADY ONE FOR THE RECORD BOOKS

With the Dow up around 10,000, here's a dark indicator to add to the mix: A record number of companies have filed for bankruptcy so far this year. Through Oct. 15, 4,585 U.S. companies filed for protection under Chapter 11, says Richard Peterson, a director of Standard & Poor's Market, Credit & Risk Strategies unit. That's up 12% from last year on that date. Of those, 249 are companies taken private (or invested in) by buyout firms. That's a record, too—a 68% increase from the previous high of 148 over the same period in 2008. "Bankruptcies will continue to rise," predicts Henry Miller, chairman of investment bank Miller Buckfire, which advises on restructurings. Private-equity-backed companies remain vulnerable, he says, because so many were bought at the top of the market and loaded up with debt in the belief they would grow at a healthy clip. Now "it's not clear the economy will recover sufficiently" to meet those expectations, he says, adding that "debt capital markets also may not be in a position to refinance obligations as they come due." The biggest bankruptcy this year: General Motors, with $91 billion in assets. The private equity-backed casualties include Charter Communications ($13.6 billion), owned by entities controlled by Microsoft co-founder Paul Allen since 1998, and Reader's Digest ($2.8 billion), bought by investors led by Ripplewood Holdings in 2007. *–Emily Thornton*

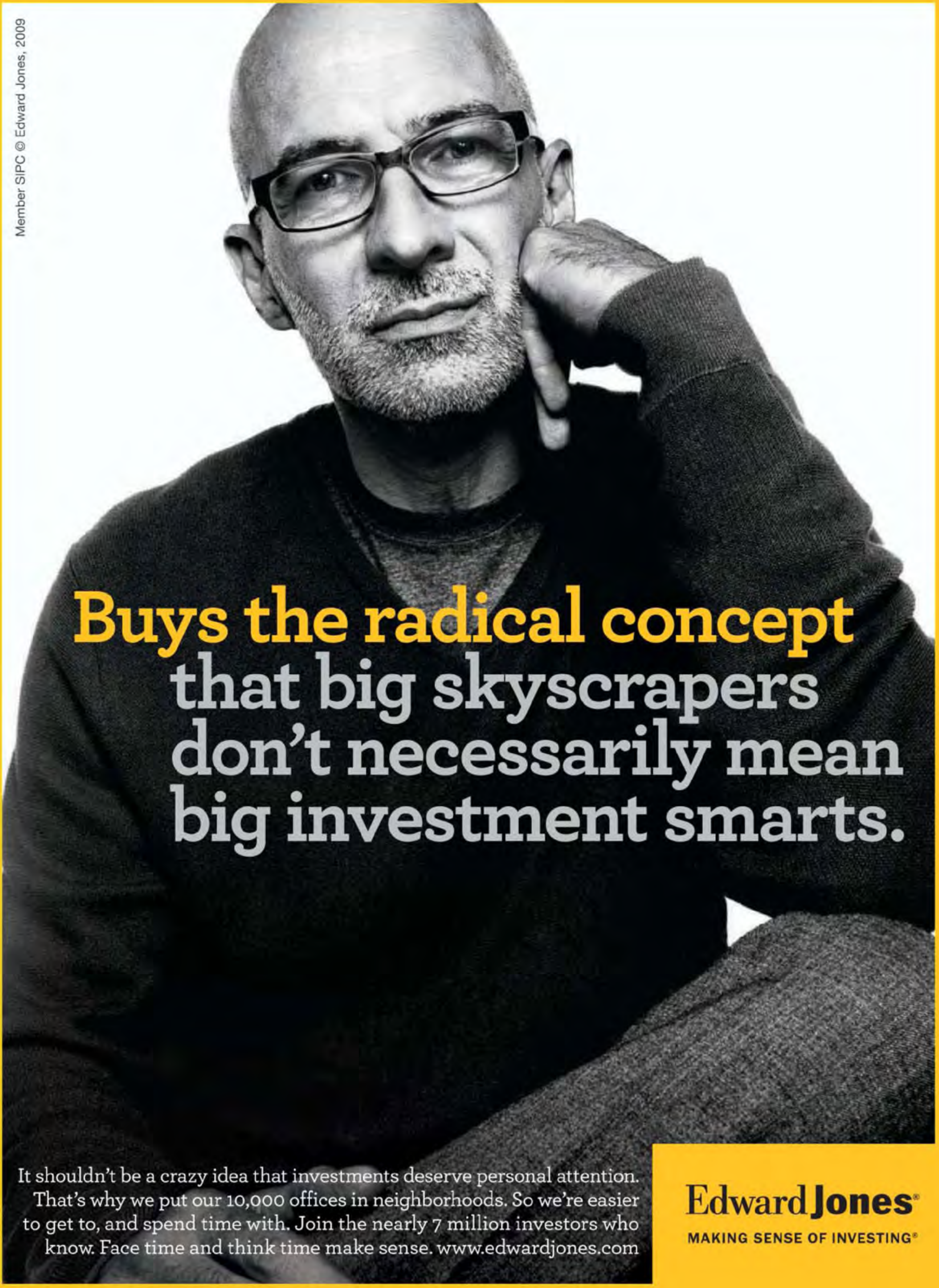
NUMBER OF PRIVATE-EQUITY-BACKED COMPANIES FILING FOR CHAPTER 11*



*As of Oct.15 in both years
Data: Capital IQ



ILLUSTRATION BY RICHARD MIA


Member SIPC © Edward Jones, 2009
Buys the radical concept that big skyscrapers don't necessarily mean big investment smarts.
It shouldn't be a crazy idea that investments deserve personal attention. That's why we put our 10,000 offices in neighborhoods. So we're easier to get to, and spend time with. Join the nearly 7 million investors who know. Face time and think time make sense. www.edwardjones.com
Edward Jones®
MAKING SENSE OF INVESTING®

FACETIME | MARIA BARTIROMO





ILLUSTRATION BY ROBERTO PARADA; (TOP) PHOTOGRAPH BYBRAD TRENT

TREASURY'S GEITHNER ON THE STATE OF THE ECONOMY

MARIA BARTIROMO
Is there enough capital in the system?

SECRETARY TIMOTHY GEITHNER
You're seeing a really dramatic improvement in access to credit. But parts of the system are still very damaged, access to credit for small business remains constrained, and there are markets, such as mortgages, where progress is enormously reliant on the government.

Right. Look at the cash-for-clunkers deal. Car sales went from horrible to great to horrible again. What happens when the stimulus is gone?
A recovery that's going to work requires a recovery led by private demand. But you still have to make sure there's enough support to reinforce that process of recovery. That's a difficult balance to get right. We're not going to make the mistake many countries made in the past of putting the brakes on too early and creating the risk of a weaker recovery with even higher levels of unemployment.

Do we need a second stimulus?
No. But Congress is looking at unemployment insurance and other programs critical to recovery. And there's a good case for extending them.

People are nervous about 2010 and new taxes. Are you going to allow the Bush tax cuts to expire if the economy remains flat and unemployment is still high?

The overwhelming responsibility of people in government today is to make sure we have an economy that's growing, unemployment coming down, factories going back to work. That is the critical imperative. That's why we cut taxes for 95% of working Americans and for businesses across the country. It does not make sense to raise taxes in a recession.

How worried are you about the deficits?
When we have an economy that's growing again and we get unemployment down, we're going to have to bring those deficits down. And we need to make sure people understand we will do that. Because if they're not confident in that, the recovery will be weaker, interest rates will be higher, investment will be constrained, and you'll have higher unemployment. Deficits can be very damaging to growth.

When do you expect growth in jobs?
I'm not an economist, and I don't forecast, but if you look at what business economists say now, you're going to see the economy growing at a significant rate for the rest of this year. Then positive growth in 2010 at a level that will begin to gradually bring down the unemployment rate.

World Bank President Robert Zoellick recently said that the U.S. should not take for granted the dollar's preeminence. Would you expect, at some point, that the dollar will not be the world reserve currency?
I wouldn't. But I think the dollar's role in the system requires us to do everything possible to keep inflation low and make sure we're getting our fiscal house in order. That's really important to confidence [in the dollar]. We take that very seriously—nobody more than me.

The object of reform is to ... have a system in which we can let firms fail without taxpayers being on the hook



Geithner suggests unemployment could start coming down next year

FREDERIC LAFARGUE/RAPPORT

Here we are at Dow 10,000, and JPMorgan and Goldman Sachs are once again reporting great numbers and paying record bonuses. And yet 10% of the country is unemployed. Some people out there are saying: "Did we get snookered again? Have we learned anything?"
We're not going to let this financial system go back to where it was, and we're not going to let the practices reemerge that caused this crisis. That's very, very important, and the financial community has a huge interest in a more stable framework with better protections for the industry. The best-run firms were disadvantaged by the worst-run.

But we're still dealing today with too big to fail, aren't we?
At the center of any reform process is making sure institutions are not living with the expectation the taxpayer is going to save them from their mistakes. The object of reform—apart from what we're trying to do on the consumer side—is to make sure we have a system in which we can let firms fail without taxpayers being on the hook. And we're going to do that.

Won't a consumer protection agency just be one more bureaucracy?
This basic balance between [financial] innovation and protection is really important to get right. But we got it wrong. There's no way to look at our system the way it was run and say we did an adequate job of protecting consumers and investors. Of course we want to make sure there's innovation and choice, but I think we found that balance in the proposals we made to Congress.

Some people feel there's real class warfare going on, and when you look at some Administration policies—whether it's cap and trade or higher taxes, or in some cases higher health-care costs—it feels a little anti-business. Is this Administration anti-business?
Absolutely not. And the President and the people around him understand deeply that for our economy to be more productive in the future, it requires an atmosphere in which businesses are willing to innovate, invest, and take risk. There's no path to growth, no path to lower unemployment, no path to broad-based gains in income that doesn't come from and rely on an atmosphere in which investors are confident and companies are confident. |BW|

Maria Bartiromo is the anchor of CNBC's Closing Bell and writes the blog Maria Bartiromo's Investor Agenda at investoragenda.cnbc.com

How can we squeeze

more food from a

RAINDROP?



Farming feeds the world, but it depends on vital natural resources. Just consider this: irrigation for agriculture consumes 2/3 of the world's fresh water withdrawals.

Experts have concluded that agricultural output will need to double by 2050 to feed a growing world. We'll need to get more from each drop of irrigated water.

We'll also need to do more with the solution nature already provides: rain.

The challenge for farmers is squeezing the most out of unpredictable rainfall. That requires putting the latest science-based tools in farmers' hands, including advanced hybrid and biotech seeds. Our goal is to develop seeds that significantly increase crop yields and can help farmers use 1/3 less water per unit produced.

Producing more. Conserving more. Improving farmers' lives. That's sustainable agriculture. And that's what Monsanto is all about.

Non-irrigated agriculture produces 60% of the world's food. It will need to do more.

MONSANTO
imagine®

Learn more at: **www.ProduceMoreConserveMore.com**

PRODUCING MORE | CONSERVING MORE | IMPROVING FARMERS' LIVES

© 2008 Monsanto Co. Monsanto Imagine and the Vine Design are trademarks of Monsanto Technology LLC.

025 The SEC: To Catch a Cheat
026 Earnings: New accounting magic
028 Tech: What's slowing a rebound
030 The Recovery: Bottlenecks ahead
032 Piracy: The Chinese get serious
034 Nissan: A painful overexpansion?

WHO PICKS UP THE TAB FOR HEALTH REFORM

Insurers and taxpayers are likely to pay big chunks of the $900 billion bill to overhaul the nation's health-care system. Doctors will feel the least pain

By Jane Sasseen and Catherine Arnst

The odds are shifting in favor of health-care reform legislation making it through Congress this year, to the point where bookies could put money on the ultimate winners and losers. Many details have yet to be determined, as congressional leaders try to merge two Senate and three House proposals, all of them more than 1,000 pages long. And beyond the contentious battle over the public insurance option, there's a huge fight over another question: Who will pay to cover the uninsured? It's safe to say doctors will give up the least, pharmaceutical and medical device makers will fall somewhere in the middle, and insurers will be the big losers.

Then there's the taxpayer. Senate Democrats want to levy a 40% excise tax on so-called Cadillac plans, policies that cost more than $21,000 a year. Backers say the tax would bring in $215 billion, but unions are determined to block it, arguing that middle-income workers will get hit with the tax as well. A fierce battle will erupt over the levy when the Senate and the House begin to work on the final bill. Meanwhile, the 85% of citizens with insurance of any kind, Cadillac or Hyundai, should probably assume that most costs levied on other parties to health reform will be passed along to them through higher premiums.

Most Washington observers now think the final bill will closely resemble the Senate Finance Committee proposal because it has a smidgen of bipartisan support, thanks to Senator Olympia Snowe (R-Me.). It also meets President Barack Obama's demands that a reform package cannot add to the federal deficit and the tab should come in at around $900 billion over 10 years. With billions in potential profits or lost benefits at stake, lobbyists are scrambling to make sure that someone else—anyone else—foots the bill. "Figuring out how to pay for this package remains the hardest thing," warns Andy Laperriere, a Washington policy analyst with institutional broker ISI Group. Nevertheless, it is possible to envision which groups will have to pony up:

HEALTH INSURERS

The insurance industry has been actively involved in efforts to craft a health-care bill ever since President

TWO WAYS TO FUND REFORM

Separate House and Senate health-care bills cover costs differently:

HOUSE TRI-COMMITTEE BILLS

10-year cost: $1.04 trillion

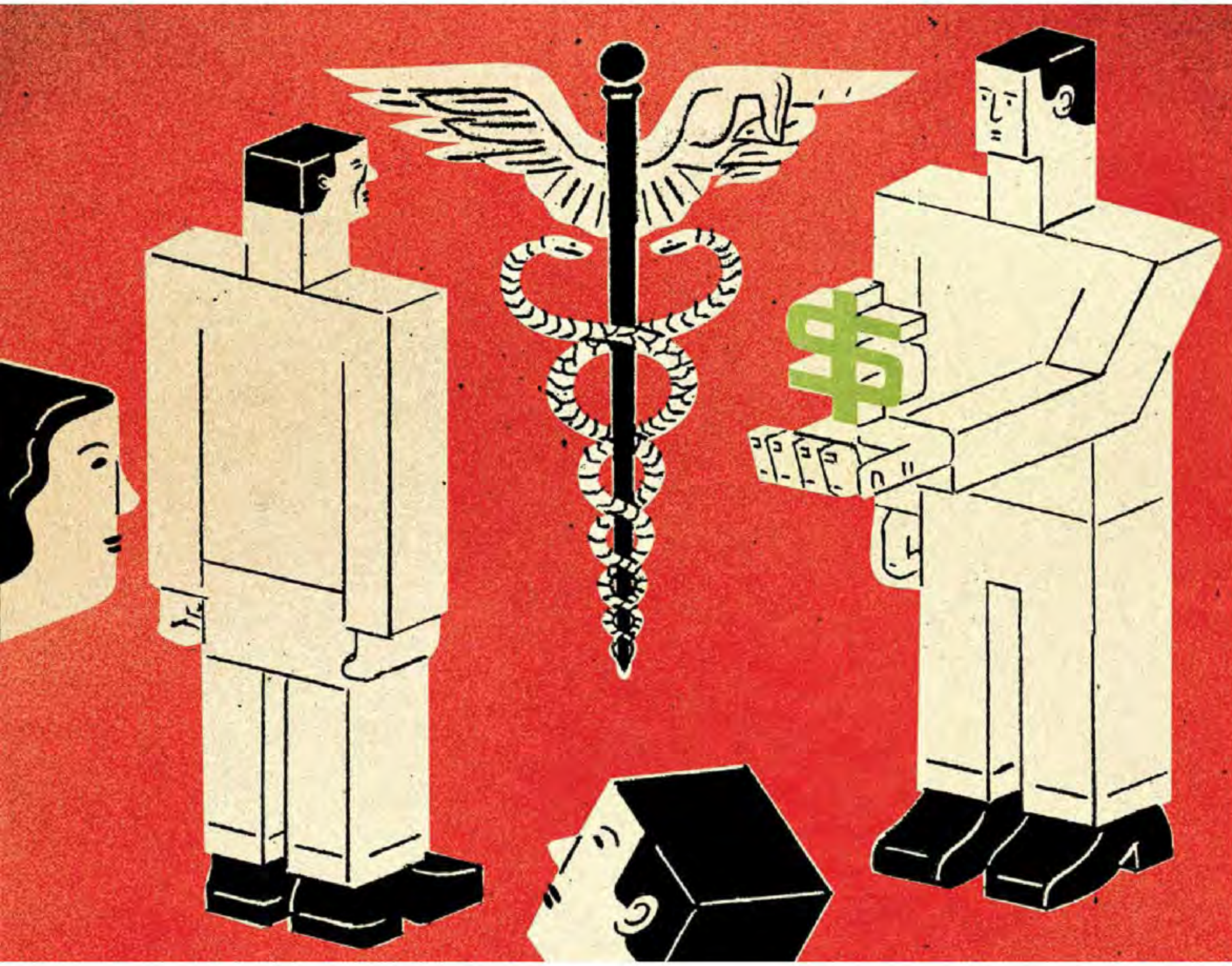
Financing: $491 billion cuts in Medicare and Medicaid; $544 billion surtax on adjusted gross income above $350,000 per family

SENATE FINANCE COMMITTEE

10-year cost: $829 billion

Financing: $471 billion cuts in Medicare and Medicaid; $215 billion excise tax on "Cadillac" health plans; $130 billion in industry fees

Data: Committee for a Responsible Federal Budget, Congressional Budget Office, Senate Finance Committee



DAVE PLUNKERT

Obama took office. Insurers have already agreed to several concessions on the assumption that they will gain 30 million or so new customers from the ranks of the uninsured. Those efforts haven't paid off the way they'd hoped. "The bill has certainly taken a turn for the worse for the [insurers]," says Rick Weissenstein, an analyst with Washington Research Group.

Lawmakers have proposed that the industry pay the government flat fees worth $67 billion over the next decade—an idea that's likely to get backing from House Speaker Nancy Pelosi (D.-Calif.). Throw in the $100 billion-plus that both chambers aim to get by cutting subsidies for Medicare Advantage plans, and the industry may have to give up more than $200 billion. "It's totally disproportionate to our share of the health-care expenditures," says Karen Ignagni, president of America's Health Insurance Plans, the industry lobby.

She argues that the industry will have no choice but to raise customers' premiums to fund the new fees. Moreover, a mandate requiring everyone to buy insurance or pay a fine has been so watered down that insurers won't gain enough new customers—the basis for their reform support in the first place.

On top of that, the House Judiciary Committee voted on Oct. 21 to end the industry's 60-year-old exemption from federal antitrust laws. "The insurance companies are obviously turning into the villain here," says Laperriere. "The chances are more likely that their costs will go up, not down."

DRUG AND MEDICAL-DEVICE MAKERS

There were hopes that covering the uninsured would mean a lot more customers for these companies as well. Consequently, drugmakers cut a deal with the White House in May to absorb $80 billion in cuts to Medicare reimbursements and fees over 10 years—a fraction of the industry's total revenues of more than $600 billion a year. The device makers never came to the table, and that could haunt them. Although their industry brings in only one-sixth the revenues of the drug companies, the finance bill would have them absorb $40 billion in new fees, proportionally a much bigger hit. "This is really a tax on innovation," complains Medtronic CEO William A. Hawkins, who says device makers would have to cut back on research and jobs. Their points are gaining traction. Daniel Clifton, an analyst with Strategas Research Partners, predicts the device makers' contribution will likely be notched down to around $30 billion.

DOCTORS AND HOSPITALS

If there are winners in all this turmoil, it's the white coats. Never mind that doctors and hospitals are each re-

YOU'VE GOT SOME NERVE.

Meet your business school. Entrepreneurs—both current and aspiring—find our MBA programs to be effective talent incubators. After all, questioning the presumed order is a way of life in our classrooms. If you're someone with a high tolerance for risk, we're really your safest choice.

CHICAGO BOOTH

THE UNIVERSITY OF CHICAGO BOOTH SCHOOL OF BUSINESS
CHICAGO LONDON SINGAPORE CHICAGOBOOTH.EDU

sponsible for one-third of the nation's health-care spending—far more than any other sectors—or the fact that nearly everyone acknowledges the waste in Medicare spending. Congress has proposed no major changes to the "fee-for-service" model that pays physicians for the volume of services they deliver, rather than the quality of care.

On top of that, Congress looks set to eliminate a 21% cut in Medicare payments to doctors that is already mandated under the 1997 balanced budget law. That will cost the federal government $247 billion over the next 10 years. The move is aimed at avoiding a full-out doctor revolt just as health-care reforms are within reach, so the issue—along with the hole it will leave in the budget—has been removed from the reform bill altogether. "Congress just does not have the stomach to take on the doctors," says John L. Sullivan, director of health-care research at investment bank Leerink Swann.

Hospitals also come out ahead. The American Hospital Assn. agreed last spring to absorb $150 billion in cuts over the next 10 years by instituting safety and efficiency measures, but that wasn't much of a sacrifice, says Paul H. Keckley, executive director of Deloitte Center for Health Solutions: "Every hospital is already pursuing these measures. That's why the AHA was so eager to put it on the table."

TAXPAYERS

The House bills propose raising $544 billion by imposing a 1% to 5.4% surtax on households earning an adjusted gross income of more than $350,000. Getting anything close to that amount will be difficult, however. The proposal has little support in the Senate, and even House moderates—many of whom face reelection in fiscally conservative, Republican-leaning districts—oppose it. Already, Pelosi has hinted that the threshold might be shifted so that only individuals making over $500,000 or families earning more than $1 million get hit. That may be more politically acceptable, but it will raise a lot less money. Which means going back to someone else's well. |BW|



Rajaratnam: The case against him was built with techniques used to trap drug lords

THE SEC: TO CATCH A CHEAT

From wiretaps to innovative software to informants, the agency is changing the way it goes after rogue traders

By Roben Farzad and Theo Francis

Insider-trading scandals have been a fact of market life since the Dutch were hawking East India Tea. The high-stakes bust on Oct. 16 of Raj Rajaratnam, the billionaire founder of hedge fund Galleon Management, for allegedly trafficking in ill-gotten information rounded up a diverse cast of characters: investment analysts, corporate executives, and clock-punchers.

But the Securities & Exchange Commission's steps against Galleon signal a new offensive against the notoriously difficult-to-prosecute crime. Armed with informants, wiretaps, and sophisticated software tools, the agency—still smarting after missing Bernard Madoff's Ponzi scheme—is determined to raise its game. "It would be wise for investment advisers and corporate executives to closely look at [the Galleon] case and consider what lessons can be learned and applied to their own operations," SEC enforcement chief Robert Khuzami said in a press conference.

The Galleon case is notable for its unusual reliance on wiretaps and informants. The SEC drew on the resources of the U.S. Attorney's Office for the Southern District of New York, which brought criminal charges. Both agencies suggest such tactics will become more common, especially if lawmakers pass a bill proposed this month making it easier for them to share information.

Closer ties between new SEC officials and key federal prosecutors are likely to speed up insider-trading cases

Such efforts are a big change: The SEC's most covert strategy used to be cold-calling executives about recent trades, say former agency officials. Notes Wayne Black, a private financial-crime investigator and former drug cop: "The fact that they used the stuff you see for mobsters, drugs, and terrorism shows they're very serious."

While the Galleon case grew out of old-fashioned detective work, the SEC is using another set of crime-fighting tools with increasing frequency. In March the agency retained the Center for Enterprise Modernization, a federally funded arm of the nonprofit public-service organization MITRE, to help vet thousands of tips and come up with new digital tools. The SEC is also ramping up its in-house data analysis.

THE BROKER AND THE BUNNY

The agency currently relies heavily on data-mining from the Financial Industry Regulatory Authority (FINRA) and other regulators. FINRA has some 50 people sifting through trades for signs of suspicious activity, including two dozen dedicated to insider trading. FINRA then alerts the SEC and others to red flags. Such data-mining prompted the SEC's insider-trading case in December against Lehman Brothers' broker Matthew Devlin and others accused of circulating tips to a group that included former *Playboy* playmate Maria Checa.

The close ties between new SEC officials and key federal prosecutors may also speed up the process. Most insider-trading cases are joint efforts between the SEC, which brings civil charges, and the office of the U.S. Attorney, which brings criminal charges. SEC attorneys in the past have felt that federal investigators were unfamiliar with securities laws, holding up some investigations for weeks or months.

But Khuzami is an alum of the U.S. Attorney's Office in Manhattan who made his name hunting terrorists in the wake of the 1993 World Trade Center bombing. He also headed a securities fraud task force for three years. "You have three top people at the SEC who know the criminal process," says Fiona A. Philip, a partner at law firm Howrey and former enforcement counsel to the SEC chairman. "There's a level of trust there." |BW|

LOUIS LANZANO/AP PHOTO

MAGIC TRICKS ON THE CORPORATE BOOKS

With the stroke of a pen, companies can make themselves appear more financially fit than they are

By Mara Der Hovanesian

Accounting shenanigans bubble to the surface every few years. In the dot-com days the trick was to book virtual revenues. After the tech bust, tinkering with expenses was all the rage. Now forensic auditors and analysts worry that troubled companies are playing fast and loose with asset valuations and cash management.

These recent numbers games, which rely on some familiar techniques, may be the most troublesome yet. Companies that employ aggressive accounting tactics aren't just inflating earnings and cash flow—their motive may also be to hide a true financial picture from lenders to avoid losing credit and other lifelines. "It's not like a penny of earnings-per-share problem," says Mark LaMonte, chief credit officer at ratings agency Moody's Investors Service. "These things will knock you off the cliff completely." And the gimmicks only underscore the tenuous nature of the earnings recovery, which currently is lifting investors' spirits.

New discretionary accounting rules have made it easier for companies to engage in such behavior. In recent years companies have moved to "fair value" accounting, in which assets are based on current market conditions rather than on historical prices. With many markets like real estate drying up and buyers fleeing, the exercise isn't an exact science. "When it comes to valuation, what one person thinks can be completely different from the next," says John P. Glynn, a partner at PricewaterhouseCoopers who heads the firm's valuation practice. The fear is that companies may be relying on inflated estimates for all sorts of assets, including contracts, commodities, and real estate. If so, some nasty surprises for investors and lenders may be lurking on the books.

THE ART OF ACCOUNTING

Some red flags that may be lurking in the numbers

AREA	POTENTIAL PROBLEM
Goodwill	Companies may be booking boom-time acquisitions at inflated prices
Accounts Payable	Some businesses are putting off paying bills, which boosts cash flow temporarily
Accounts Receivable	Managers may be recording payments from customers who likely won't pay

Data: *BusinessWeek*

DELAYING WRITEDOWNS?

Consider the accounting for boom-time acquisitions. When a company purchases another business, it books any premium paid as an asset called goodwill. Amid the bust, many deals have eroded in value. But corporate accountants, who have a lot of leeway under the accounting rules, may be delaying writedowns until the last possible moment. When they recognize the acquisition-related loss, the hit could be substantial. "We won't see the problem until it's clearly worse than expected," says Richard G. Sloan, a professor at University of California at Berkeley Haas School of Business.

That's just the kind of situation investors in Huron Consulting Group could face. The firm, launched by former consultants of the defunct Arthur Andersen Group, snapped up several companies after going public in 2004. Huron's related goodwill: $506.5 million, according to research firm Audit Integrity. But the researchers figure goodwill shouldn't be that high, and estimate Huron has inflated its earnings over the years by $56 million.

The company already restated three years of earnings for compensation issues related to those acquisitions, revising profits during the period from $120 million to $63 million on July 31. The Securities & Exchange Commission is investigating the restatement, according to the company's Aug. 19 earnings conference. Huron says it's cooperating.



To ferret out potential problems, accountants look for companies whose goodwill assets amount to 20% or more of total assets. That's a sign that goodwill is making up an increasingly large portion of the balance sheet—and profits may get whacked later. Goodwill represents more than 65% of Huron's assets. In January, Gannett announced a $7.46 billion writedown on goodwill, which at the time represented 45% of assets.

More companies may run into problems. An Audit Integrity report found that of the 5,514 companies with a market value of more than $100 million, 668 have goodwill assets above the 20% mark. The list includes such debt-burdened businesses as Virgin Media and TicketMaster Entertainment. Both declined to comment.

Another warning sign may be a growing pile of "accrued" assets. In so-called accrual accounting, companies recognize a sale or expense when the transaction is made rather



ILLUSTRATION BY PAUL BLOW

than when the cash is exchanged. As a result, cash flows and profits don't always match up. "If it's not cash, there's a high level of uncertainty and subjectivity," says Brent Miller, a forensic analyst at Gradient Analytics.

The concern is that companies are dressing up results by using these tactics. Take Amazon.com. Its mainstay business of selling books, DVDs, and CDs was flat in the second quarter. But cash flow looked healthy. (Amazon was set to report third-quarter earnings after *BusinessWeek* went to press.)

Why weren't profits and cash flow in sync? Some analysts speculate that Amazon may be managing its accounts payable, the money it owes suppliers. Analyst Jeffrey B. Middleswart of Behind the Numbers, a research firm for short sellers, figures that accounts payable amount to 195% of Amazon's inventory—meaning the company is selling the goods to customers long before it pays suppliers. As of the second quarter, Amazon was taking 65 days to pay bills, vs. 58 at the start of the year.

The gimmicks only underscore the tenuous nature of the earnings recovery, which is lifting investors' spirits

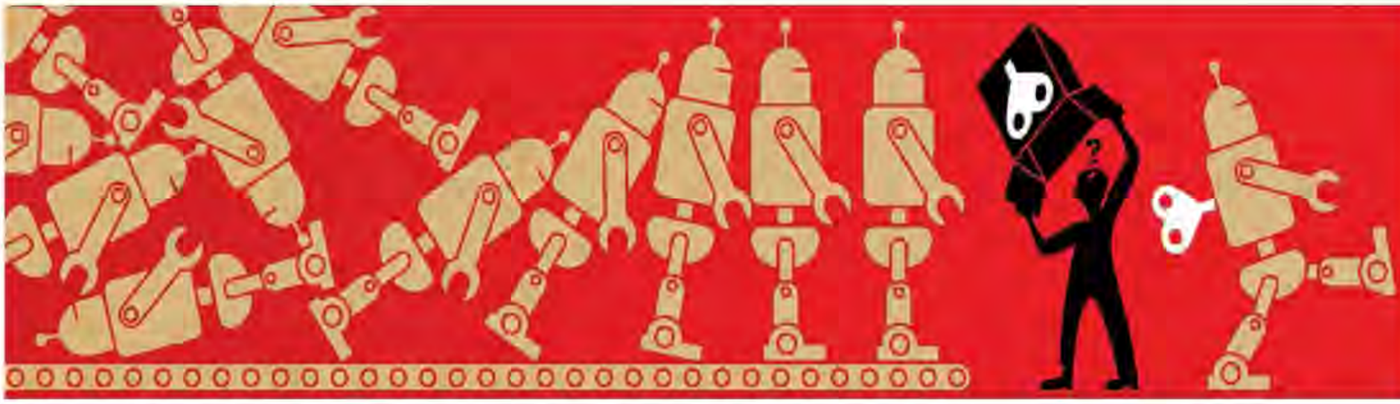
Says Colin W. Gillis of research firm Brigantine Advisors: "They make money on the backs of suppliers."

Such moves, Middleswart estimates, accounted for 70% of Amazon's cash flow in the most recent 12 months. "Think of this as a rubber band being stretched," he says. "[The company] cannot maintain the situation." Eventually the company has to pay up, which could crimp cash flow. One analyst said Amazon doesn't have any accounting problems, and "there's some aggressive shorts out there who want to knock it down." Amazon declined to comment.

On the flip side, some companies may be too optimistic about their delinquent customers. Managers classify those accounts receivables as "doubtful" if they think they won't get paid. They then take a related loss to build reserves. But analysts say some companies are pushing off the day of reckoning by extending the number of days the accounts are considered current.

First Solar, an energy equipment manufacturer, may be among those doing so. Roughly one-fifth of its clients are renegotiating contracts to get lower prices, says Middleswart. But First Solar doesn't seem to be recording those accounts as doubtful. The company didn't set aside any reserves for the contracts until the second quarter, when it took a tiny $7 million charge related to accounts receivables. "There is not that much transparency about how they book revenues," says analyst Ben Pang of research firm Caris & Co. "We're concerned if [First Solar] is making the pricing look better near term." First Solar declined to comment.

Pundits can't decide whether the recession is prompting such games or whether these are longtime trangressions just coming to light during tough times. Either way, the problems raise questions about the quality of corporate profits—a situation regulators likely will watch closely. "One of the things people misunderstand is that manipulating accounts doesn't have to be complicated," says Toby J.F. Bishop, director of the Deloitte Forensic Center, an arm of the accounting firm. "It can be done simply with the stroke of a pen." |BW|



WHAT'S HOLDING BACK TECH

The surprise surge in demand for PCs and handsets has the industry scrambling to get the supply chain humming

By Steve Hamm

When mobile-phone giant Nokia reported a surprising third-quarter loss of $832 million Oct. 15, it placed some of the blame on shortages of handset components. "We would have sold more phones in the third quarter without the capacity constraints," declared Chief Executive Olli-Pekka Kallasvuo.

Suddenly, after a yearlong slump, there's a bounce back in demand for tech gizmos—everything from smartphones to laptop PCs. Market researcher Gartner had expected PC shipments to decline 5.6% in the third quarter but instead found that sales had increased by 0.5%. Now spot shortages are showing up in a wide range of components, including digital camera modules, LCD screens, and memory chips, because production was lowered dramatically during the recession. Think of the global tech industry as a huge machine that has been running at half speed but sputters and backfires as it throttles up.

The coming months could be tricky. Manufacturers must gauge demand accurately amid economic uncertainty. Their suppliers have to ramp up production without overshooting. The ones that manage supply chains best will come out ahead as the recession eases. "Most suppliers are in true survival mode, and they're going to be very conservative about expansion," says analyst Eric Pratt at tech market researcher iSuppli.

18

Number of weeks it takes to fill orders for megahertz crystals, a key component of cell phones

Data: iSuppli

Given the depth of the recession, the sudden rekindling of demand in late summer surprised tech leaders. Microprocessor maker Intel says it's garnering more orders than it expected, including for its new processors for corporate server computers. It's ramping up inventories.

But imbalances could persist in other industry segments. No company has built a fabrication plant for the essential dynamic random-access microchips found in computers since 2007. James Kim, vice-president at Korea's Hynix Semiconductor, the second-largest DRAM maker, expects supplies to be tight through next year. Meanwhile, DRAM prices increased 40% between the first and third quarters, according to market researcher IDC.

When the economy shifts, it can take months to bring dormant factories to life. Texas Instruments completed a $320 million factory in Texas in 2006 but never started it up. Now TI is installing equipment in the factory but won't be manufacturing chips in high volumes there until late 2010.

MANAGING FLUCTUATION

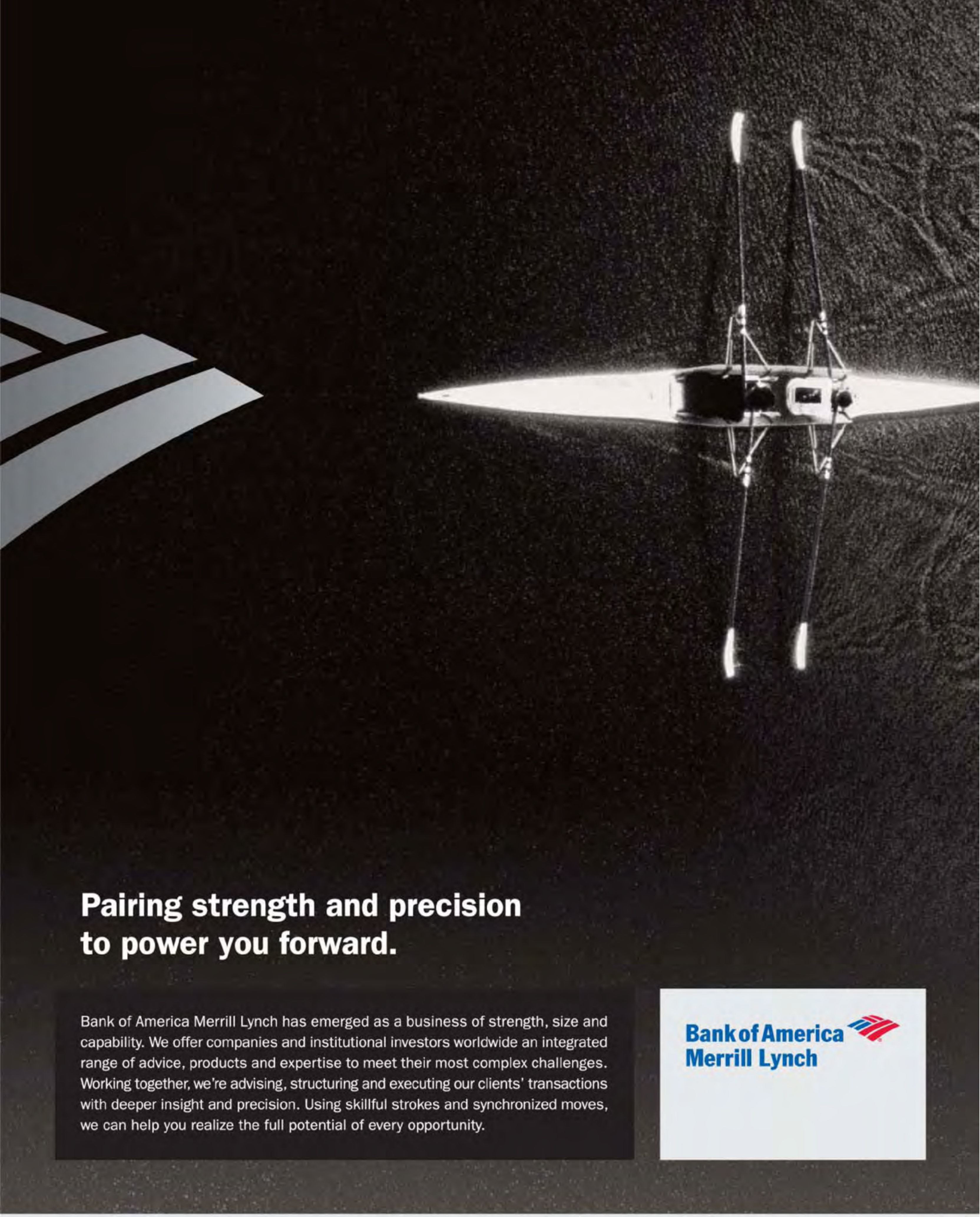
Some tech companies made moves during the downturn that are helping them react more quickly today. Linear Technology, which makes chips for cell phones and cars, decided last year to keep its four plants operating and didn't lay off employees—unlike its competitors. Instead, it staged rolling factory shutdowns. Now it's able to fill orders in two to four weeks. "Our sense was the business would come back, but we didn't expect it to come back so quickly," says Chief Executive Lothar Maier.

Will tech industry demand keep climbing? PC makers have high hopes that the release of Microsoft's Windows 7 operating system will stimulate powerful demand for new PCs, but analysts are skeptical. "People won't buy new PCs for Windows 7. They'll only buy them if they need them," says analyst Mikako Kitagawa of Gartner.

In fact, some analysts say today's uptick in orders for PCs and handsets is caused mainly by retailers restocking in anticipation of strong holiday sales. If consumers don't spend, the tech industry's mini-recovery will turn into a bust—and nobody will be fretting over component shortages anymore. |BW|

—With Moon Ihlwan in Seoul and Andy Reinhardt in London

ILLUSTRATION BY THOMAS FUCHS



"Bank of America Merrill Lynch" is the marketing name for the global banking and global markets businesses of Bank of America Corporation. Lending, derivatives, and other commercial banking activities are performed globally by banking affiliates of Bank of America Corporation, including Bank of America, N.A., member FDIC. Securities, strategic advisory, and other investment banking activities are performed globally by investment banking affiliates of Bank of America Corporation ("Investment Banking Affiliates"), including, in the United States, Banc of America Securities LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, which are both registered broker-dealers and members of FINRA and SIPC, and, in other jurisdictions, locally registered entities. Investment products offered by Investment Banking Affiliates: Are Not FDIC Insured • May Lose Value • Are Not Bank Guaranteed. ©2009 Bank of America Corporation AR83652

BEWARE THE BOTTLENECKS

Isolated shortages early in the recovery could strain production—and that could lead to inflation



ILLUSTRATION BY THOMAS FUCHS

By Peter Coy

The one nice thing about a devastating recession is that everything's on sale: Whatever you need is readily available in big heaps, and inflation isn't a problem because sellers are eager to dump their excess supplies. That's why it's a little surprising, not to mention worrisome, that scattered shortages have emerged recently in an assortment of items ranging from economy cars and consumer electronics to such oddities as canned pumpkin and lobster bait.

Are these isolated shortages an early warning that there's less slack in the economy than commonly believed? If so, more bottlenecks could form as the economy gains speed and demand grows. And that, in turn, could drive up prices and force the Federal Reserve to raise rates before the recovery ever hits its stride.

Inflation hawks such as James B. Bullard, president of the Federal Reserve Bank of St. Louis, remember the deep recession of 1974-75, when the Fed overestimated the amount of unused productive capacity in the system. As a result of that mistake, the Fed kept monetary policy too easy and wound up with high inflation. Says Bullard: "I don't want to replay the '70s."

STAGFLATION'S SHADOW

Bullard is in a minority, to be sure. The predominant view among economists, business executives, and supply-chain experts is that shortages are mostly short-term problems that won't harm the overall economy. They say the bigger and scarier risk is deflation: an economic contraction that causes falling prices, more unemployment, and bankruptcies.

Nevertheless, even some economists who worry mostly about sluggish demand and falling prices say it's worth considering the possibility of inflationary glitches in the supply chain. For one thing, the ongoing credit crunch may be having some unexpected consequences. If weakened companies can't raise the funds they





need to expand their capacity, they won't be able to respond to increasing demand. That could produce some ugly combination of higher prices and constrained growth—in a word, stagflation.

Factory closings have recently reduced U.S. industrial capacity at the fastest pace since record keeping began in 1967 (chart). David Hensley, global economics coordinator for JPMorgan Chase, calls himself a "big believer" in the danger of deflation but adds: "This is a unique environment with lots of crosscurrents. I don't think we want to be overly wedded to one model" that says deflation is the only risk.

The auto sector would seem to be one that's vulnerable to supply disruptions despite the massive decline in sales. Automakers have decreased their capacity at the most rapid pace since World War II, according to Federal Reserve data. That capacity reduction has helped prop up prices. Surprisingly, new-vehicle prices rose 1.6% in the year through September.

The cash-for-clunkers program, by spiking sales, produced shortages for selected vehicles, including the Ford Escape and Chevy Cobalt. Steel and parts for the vehicles were in short supply. In an interview on Oct. 19, General Motors CEO Fritz Henderson said when he asked his staff about the shortages, "the answer came back resoundingly that it was a temporary problem." Still, the financial difficulties of auto and parts makers increase the risk that they won't be able to attract financing for needed expansions.

The Fed would have an easier time if it could focus on just one enemy, deflation. But it can't entirely ignore the opposite threat, capacity bottlenecks leading to inflation. The central bank must be prepared to fight a war on two fronts. |BW|

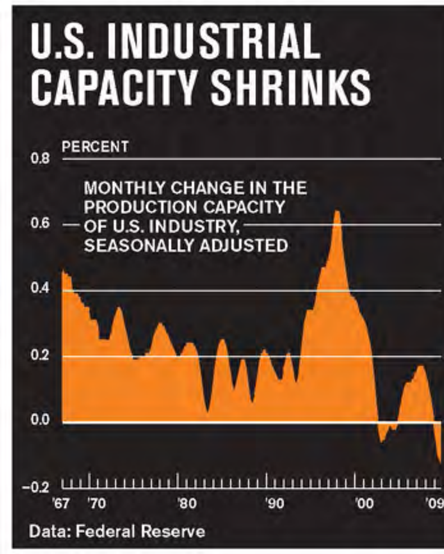
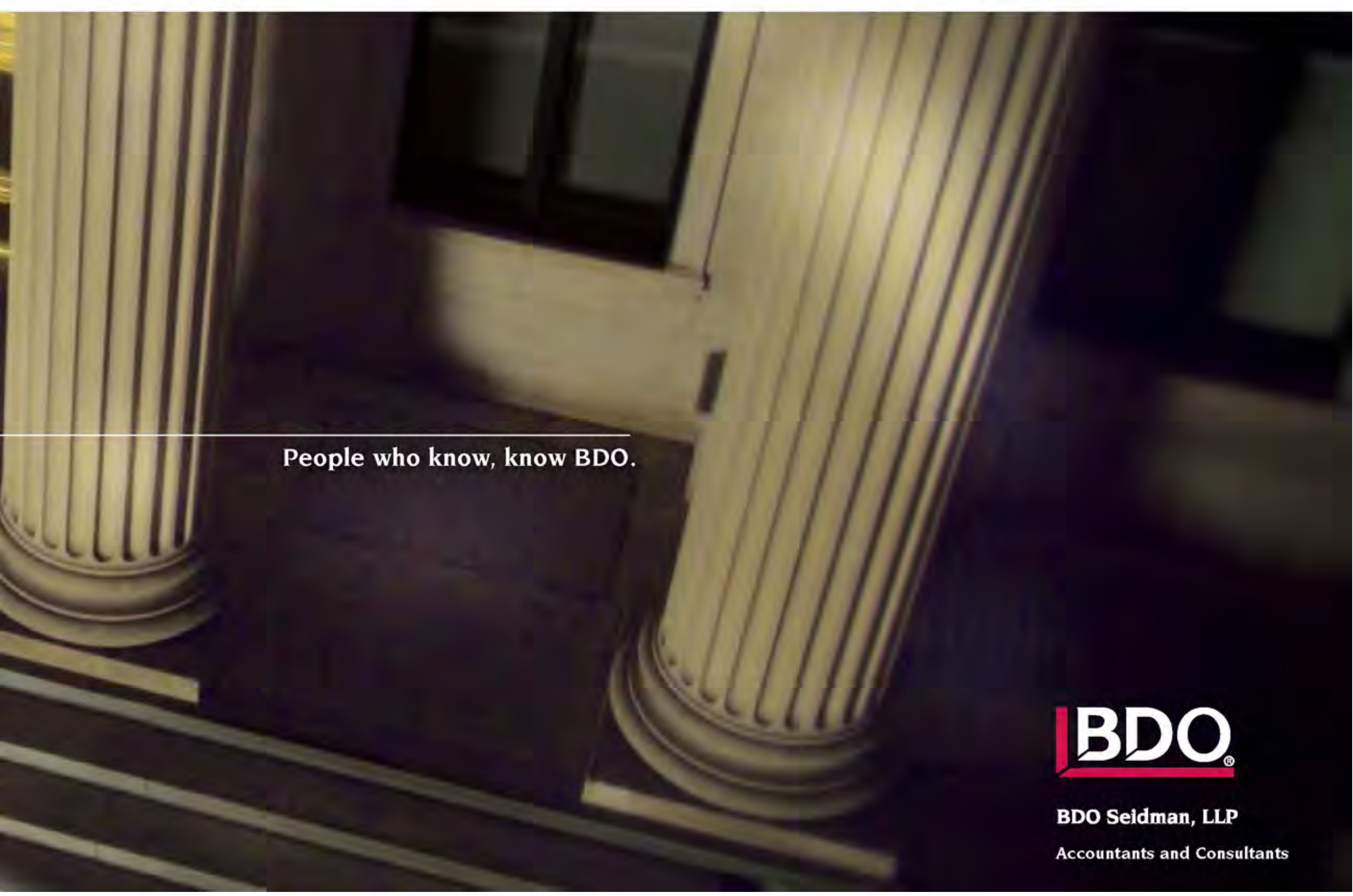


CHART BY DAVID FOSTER





Chinese police seize a suitcase stuffed with pirated DVD movies

AFP/GETTY IMAGES

CHINA'S NEW PIRACY COPS: WEB SITES

Western companies hope domestic disputes mean Beijing will get serious about intellectual property theft

By Bruce Einhorn

Victor Koo was looking for a way to make his video-sharing Web site stand out from China's legions of similar outfits. So the founder of Beijing's Youku.com arranged a pay-per-view special with Guo Degang, a comedian known for dialogues vaguely akin to the "Who's on First" routine by Abbott & Costello. For $7.30, subscribers could watch eight nights of Guo's fast-paced schtick, only on Youku.

Or at least that's what Koo thought. Soon after the Guo shows aired in August, Koo says, unauthorized copies started appearing on rival Sohu.com. That touched off a running battle among the kingpins of China's Internet. In September, Sohu and several other Net companies sued Youku and a handful of similar sites for airing videos without permission. Youku responded with lawsuits of its own, alleging defamation as well as illegal use of the Guo videos. "They make these announcements about us infringing their content, and the next day we still find evidence they violated our copyrights," fumes Koo, who once served as president of Sohu. Koo's lawsuit, counters Sohu chief Charles Zhang, is "pathetic."

Angry words aside, it seems the Chinese are beginning to get serious about piracy. While multinationals have battled intellectual property theft in China for years, Chinese companies have largely stayed on the sidelines. But as domestic players start to take umbrage at rivals stealing their wares, they're jumping into the fray—which may soon lead to better protection. If only foreigners complain, "it's an uphill struggle," says Michael C. Ellis, president of Asia-Pacific for the Motion Picture Assn., a trade group. But now "local industry is starting to realize the losses they are suffering."

$82 million

Legal music sales (CDs and downloads) in China in 2009, vs. $4.9 billion in the U.S.

Data: International Federation of the Phonographic Industry

China's video sites say they're doing their best to battle pirated content. They have introduced new technology to keep unauthorized videos offline and are quicker to take down those that make it through. "We always remove links" to pirated clips, says Gary Wang, chief executive of Tudou.com, another video-sharing site targeted by Sohu and its allies. For his part, Sohu boss Zhang argues that his company and its allies have spurred more Chinese sites to follow the rules. "Last year you could steal things in broad daylight," Zhang says. "Now, because of our efforts, you do it very discreetly."

Dan Brown, author of *The Da Vinci Code*, has already gained from the changing attitude. A Web site that had recruited more than 1,000 volunteers to collaborate on an unauthorized translation of Brown's latest novel, *The Lost Symbol*, pulled the plug on the initiative in September after a warning from the publisher that held the local rights to the book. To avoid "serious copyright consequences," the moderator wrote on the site, "I suggest that everyone suspend translating."

But plenty of demand remains. Prices for legitimate content have skyrocketed; site operators now pay $5,000 per episode, vs. $500 a year ago. And Beijing permits just a few dozen foreign films annually in Chinese cinemas—an invitation to piracy. "Unless you open the door to [foreign content], people will always find illegal ways to get it here," says Thierry Raymaekers, business development chief at Irdeto, a company that sells anti-piracy technology to cable TV operators.

That means copyright holders have a long road ahead. Lawsuits by foreign record companies against Chinese search engines for allegedly providing easy access to pirated songs have languished for more than a year, says Leong May-Seey, regional director for the International Federation of the Phonographic Industry. "It's just taking forever." |BW|

—With Huang Zhe in Beijing

✓ YES, send my FREE Flat Rate Boxes.



To get your FREE Flat Rate Boxes:

- **Mail in this card or**
- **Visit prioritymail.com/boxes17**

FIRST NAME ____________ LAST NAME ____________

TITLE ____________

COMPANY NAME ____________ TYPE OF BUSINESS/INDUSTRY ____________

ADDRESS ____________ DEPT./MAIL STOP ____________

CITY ____________ STATE ____________ ZIP™ CODE ____________

E-MAIL ADDRESS ____________ TELEPHONE ____________

First, please tell us a few things about your business:

1. On average, how many packages do you ship daily?
☐ 1–12 ☐ 13–49 ☐ 50–100 ☐ 101+

2. How much do most of your packages weigh?
☐ Less than 10 lbs. ☐ More than 10 lbs.

3. Who/where do you mainly ship to? *Please check all that apply.*
☐ Businesses ☐ Consumers ☐ International destinations

4. Who is your primary shipper? *Please check all that apply.*
☐ The U.S. Postal Service® ☐ Another shipper ____________

PLEASE ACT NOW. This mail-in offer ends 11/30/09.

Choose a Priority Mail® Flat Rate Box pack.

Please check one.

★ **Variety 4-pack**	☐ One box in each size	
Small Box 8⅝" x 5⅜" x 1⅝"	☐ 10-pack	☐ 25-pack
Medium Box 13⅝" x 11⅞" x 3⅜"	☐ 10-pack	☐ 25-pack
Medium Box 11" x 8½" x 5½"	☐ 10-pack	☐ 25-pack
Large Box 12" x 12" x 5½"	☐ 10-pack	☐ 25-pack

©2009 United States Postal Service. The Eagle logo and the trade dress of USPS shipping boxes are among the many registered trademarks of the U.S. Postal Service.

EP4835

UNITED STATES
POSTAL SERVICE®

PO Box 149263
Austin TX 78714-9263

NO POSTAGE
NECESSARY
IF MAILED
IN THE
UNITED STATES

BUSINESS REPLY MAIL®

FIRST-CLASS MAIL® PERMIT NO. 73026 WASHINGTON DC

POSTAGE WILL BE PAID BY ADDRESSEE

US POSTAL SERVICE®
PO BOX 149263
AUSTIN TX 78714-9632

Ship to any state for a low flat rate.



It's simple.

If it fits, it ships®* anywhere in the country for a low flat rate. • There's no need to weigh anything under 70 lbs. Four sizes for you to choose from, starting at $4.95. • When you're ready to ship, we'll pick them up for free.†

Get a free supply of Priority Mail® Flat Rate Boxes at prioritymail.com/boxes17

Priority Mail Flat Rate
A simpler way to ship.

UNITED STATES POSTAL SERVICE®

* For mailable items up to 70 lbs. Visit usps.com for details.
† For complete details on Free Package Pickup, visit usps.com
©2009 United States Postal Service. The Eagle logo, the trade dress of USPS shipping boxes, and letter carrier uniform are among the many registered trademarks of the U.S. Postal Service.

034

RISKY BUSINESS AT NISSAN

It's keeping its huge extra capacity, betting on a market rebound and solid demand for trucks and electric cars

By David Welch and Ian Rowley

When Toyota Motor is closing a U.S. factory and delaying opening another, you'd expect lesser players to follow suit. Yet Nissan Motor has no plans to reduce its manufacturing capacity in the U.S. "I've absolutely no worry about using our capacity in the U.S. in the short term," says Chief Executive Carlos Ghosn.

That optimism—some would say hubris—could come back to bite the company. Nissan can produce 950,000 vehicles in the U.S., but with sales in the tank, the automaker is on pace to build 418,000. In other words, Nissan says it is using only 44% of its U.S. production capacity. "Nissan really ramped up, and at one point it looked like they needed it," says IHS Global Insight analyst Rebecca Lindland. "It's now obvious that they don't."

When times were good, Ghosn was eager to grab market share in the U.S. He aggressively expanded the number of models Nissan fielded and six years ago opened a second U.S. plant, a sprawling facility in Canton, Miss.

Ghosn's greatest overreach may have been trying to crack the market for pickup trucks, minivans, and big SUVs—long dominated by Detroit. Even when sales were robust, Nissan's trucks, minivans, and SUVs missed their sales targets. This month the company stopped producing the Quest minivan in Canton, and it plans to stop making the Infiniti QX56 large SUV there next year. Nissan also can build as many as 515,000 Altima and Maxima sedans at Canton, says research firm CSM Worldwide. But Global Insight forecasts that Nissan will sell only 433,000 of the two models in 2014, when the U.S. economy should be healthier.

44%

U.S. factory capacity Nissan is on pace to use this year

Data: Nissan

OPTIMISTIC PROJECTIONS?

Given the capacity overhang, why does Ghosn seem optimistic? In the short term, he says a weak U.S. dollar may allow Nissan to export some of its American production to other markets, including countries in the Middle East that traditionally have received Nissans built in Japan. Longer term, Ghosn wants to keep plenty of factory capacity online for a couple of big bets he is making and for when the economy turns.

Ghosn figures electric cars will account for 10% of global auto sales over the next decade, and he plans to build Nissan's Leaf electric car at a plant in Smyrna, Tenn. Nissan also is pushing hard into the commercial truck business. Starting next year, it will produce medium-duty commercial trucks in Canton, going up against the likes of Ford and Daimler's Freightliner unit.

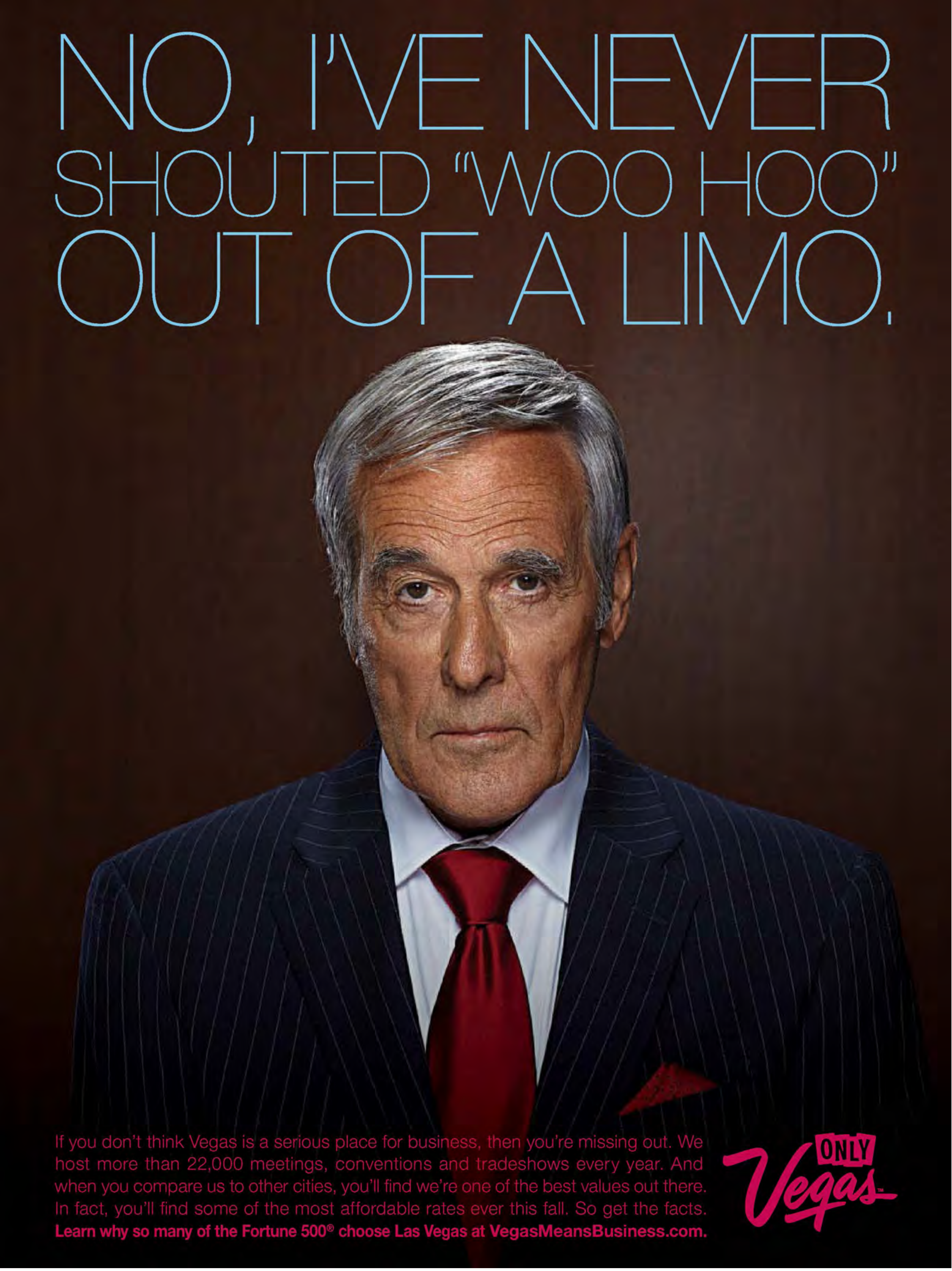
Both the electric and commercial truck bets are highly risky. Most industry watchers believe that Ghosn's projection for electric cars is way too optimistic. When Nissan launches its commercial truck next year, the U.S. market will be able to absorb only 125,000 vehicles, says Steve Tam, vice-president of the commercial vehicle sector for ACT Research. Nissan will be able to build 50,000 a year, which means it will have to steal a lot of market share to keep the factory busy. "Their target is unbelievably ambitious," Tam says.

Big ambitions are what got Nissan into this pickle. A better bet, says Michael Robinet, vice-president of CSM, may be to build some of its smaller, crossover SUVs in the U.S. because those models are selling well. Otherwise, Nissan may have to follow Toyota with the kinds of cuts that the company has so far avoided. |BW|



"I've no worry about using our capacity in the U.S. in the short term," says Ghosn

TOMOHIRO OHSUMI/BLOOMBERG NEWS


NO, I'VE NEVER SHOUTED "WOO HOO" OUT OF A LIMO.
If you don't think Vegas is a serious place for business, then you're missing out. We host more than 22,000 meetings, conventions and tradeshows every year. And when you compare us to other cities, you'll find we're one of the best values out there. In fact, you'll find some of the most affordable rates ever this fall. So get the facts.
Learn why so many of the Fortune 500® choose Las Vegas at VegasMeansBusiness.com.
ONLY Vegas™

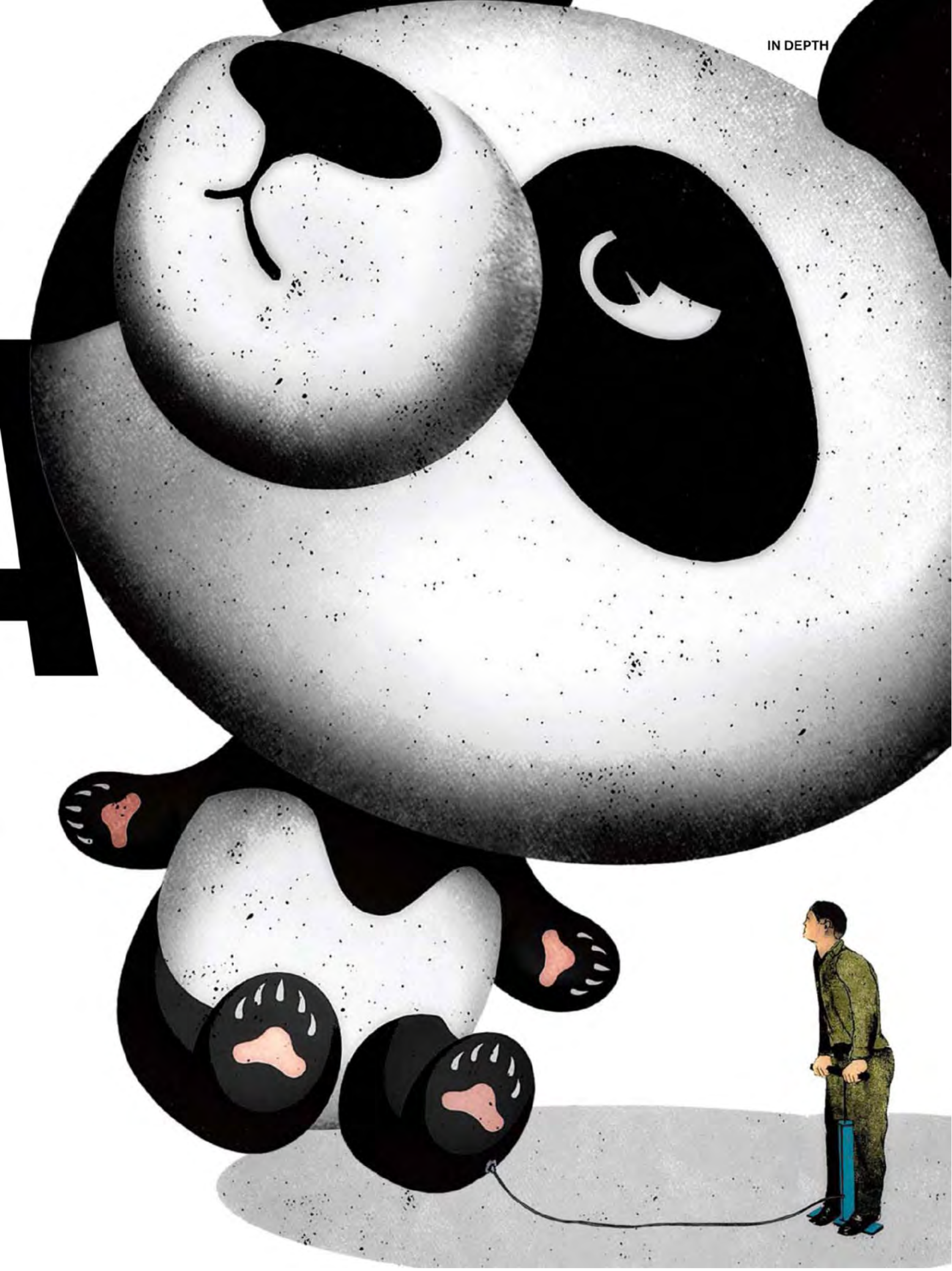
THE CHINA HYPE

By Dexter Roberts
and Pete Engardio
Illustration by Brian Stauffer

Despite an impressive rebound, an innovation shortfall may hobble sustainable growth

At the parade marking the 60th anniversary of the People's Republic of China, tanks and missiles trundled past the Forbidden City and down Beijing's Chang'an Avenue. Battalions of soldiers goose-stepped in perfect unison. Overhead, fighter jets soared in tight formation.

But close on the heels of this military extravaganza came floats highlighting a less bellicose side of China, what the leadership calls "indigenous innovation." On one, a 10-foot-high microscope, giant test tubes filled with blue liquid, and a white telescope signified China's scientific and technological achievements. Another featured a replica of a bullet train and a



passenger jet to represent China's ambitions in transportation. A green-energy float was studded with windmills and oil rigs and flanked by hundreds of red-helmeted energy-industry workers, each carrying a solar panel.

From a rostrum perched above the giant portrait of Mao Zedong at the Gate of Heavenly Peace, President Hu Jintao watched over the proceedings. "The Chinese people have stood up," Hu declared, quoting Mao, who uttered those words at that very spot 60 years ago. The country, Hu added, is "full of confidence in the bright prospects of the great rejuvenation of the nation."



RYAN PYLE/CORBIS

VINDICATION, FOR NOW

That sense of triumph permeates China these days. The mainland's quick rebound from the worldwide financial meltdown seems to have vindicated its brand of state-led capitalism. As the West struggles to recover, China is on track for 8% growth this year and is about to overtake Japan as the world's No. 2 economy and Germany as the No. 1 exporter. Now the mainland is charging ahead in new industries, unveiling homegrown airliners, electric cars, and high-speed trains.

But delve beneath the muscular statistics and hype about advances in strategic industries, and China doesn't seem so prepared to catapult into a role of global economic leadership. Experts familiar with highly touted Chinese achievements such as commercial jets and high-speed trains say the technologies that underpin them were largely developed elsewhere. There is no Chinese Sony, Toyota, or Samsung on the horizon. While Beijing's $586 billion stimulus package and a 150% increase in bank lending have spurred impressive growth, "the question," says Morgan Stanley Asia Chairman Stephen S. Roach, "is the quality of that growth."

By Beijing's own admission, the economic model that has powered China for three decades can no longer be counted on to move it forward. The mainland has prospered largely through construction and by exporting all manner of consumer goods churned out in low-wage factories; workers parked their savings in state-run banks, which then loaned the money to companies to make more stuff. But technology and managerial knowhow came mostly from multinationals, and the costs—pollution, decaying social services, and a yawning gap between the urban rich and rural poor—were largely ignored. Though that model has fueled phenomenal growth, Hu and others now call it "unbalanced" and "unsustainable."

So in recent years, Beijing has been heralding a new economic vision. The key elements: Grimy factories will give way to renewable-energy industries and a growing service sector; Chinese consumers, rather than stretched Americans and Europeans, will underpin demand; and instead of churning out me-too goods for little profit, Chinese companies are supposed to create innovative products based on home-grown technologies.

As President Barack Obama prepares for his first state visit to the mainland on Nov. 15 though, some economists are taking a skeptical look at China's evolution. While Beijing has honored many of the market-opening commitments it made to join the World Trade Organization in 2001, promised reforms such as allowing greater foreign investment in telecommunications and financial services have stalled. Over the past three years a steady stream of directives flowing from a raft of min-

CHINA TRIUMPHANT?

China is making huge strides in sophisticated industries, but skeptics say many of its products rely on imported technology and question whether mainland companies are innovative enough to compete overseas. A few examples:

AUTOS

BYD, Chery, and Geely dominate China's small-car market and generate lots of buzz about their electric vehicles. But they lag foreign brands in bigger models, and their cars may not meet Western quality and safety standards.

AIRLINERS

China's first commercial jet, the 90-seat ARJ21, hits the market next year, and a 190-seater is due by 2016. But experts say they're based on older McDonnell Douglas designs and that foreigners will supply the core systems.

CHIPS

The mainland has built eight silicon wafer plants since 2005. But last winter 60% of capacity was idle, and few Chinese chipmakers have ever been profitable. Moreover, China's technology is at least two generations behind global leaders.

SOLAR

China makes 35% of the world's solar cells, but it suffers from massive overcapacity. And its strength is in an older technology using polysilicon, while the market is shifting to harder-to-make cells based on flexible materials.

Data: iSuppli, Frost & Sullivan, *BusinessWeek*



Guizhou Province: Infrastructure remains a big driver of China's GDP growth



The C919, due out in 2016, is meant to directly challenge Boeing and Airbus

ZHOU LEI/XINHUA/XINHUA PRESS/CORBIS

istries and the National Development & Reform Commission—successor to the old central planning agency—have tightened the state's grip on the economy. In June, for example, the commission ordered that wherever possible only goods made by Chinese-owned companies be used in any project funded by the government.

The state's comeback is easy to spot. The vast majority of new loans are now going to government-controlled enterprises, for instance, while less than 20% end up at small and midsize firms, which tend to be private, Standard Chartered Bank estimates. And in strategic industries from wind turbines to nuclear power generators, Beijing is favoring its national champions and trying to whittle down the role of foreign companies. "They are rolling up the red carpet," says Joerg Wuttke, president of the European Chamber in China, which recently released a 584-page white paper arguing that China has hit the brakes on opening its economy. Says a U.S. trade official: "China's focus seems to have shifted from accelerating market reforms toward a more state-controlled model. It is very worrying."

Besides aggravating trade frictions, the Communist Party's renewed penchant for control could undermine China's competitiveness overseas. Clamping down on the ability of foreigners to do business in China would make life easier for Chinese companies at home; the downside is that it would let them avoid honing the skills needed to succeed outside the mainland. And funneling funds to state companies and connected insiders leaves creative entrepreneurs starved for capital. "The government wants to stimulate innovation and job creation but is doing the opposite," says economist Xu Xiaonian at the China Europe International Business School in Shanghai.

There are already signs that Beijing's policies are undermining the transition to a more balanced economy that might propel growth around the world. Over the past decade, consumer spending—what should be the mainstay of a new Chinese economy—has slumped from 45% of gross domestic product to 35% and now stands at about half the U.S. level. A full 88% of this year's GDP growth, Morgan Stanley's Roach estimates, will come from the usual source: fixed-asset investment in infrastructure, real estate, and yet more production lines. In the past two years, Chinese steel capacity has swelled by a third, and the mainland's idle capacity this year will nearly equal the combined steel output of the U.S. and Japan. "If anything, we are seeing a retreat to the old formula of support for large-scale manufacturing and exports," says David Hoffman, China managing director for the Conference Board, a business group.

For a glimpse of what may lie ahead if China fails to transform its economy, head to the southern city of Dongguan. The thousands of factories in the Pearl River Delta industrial hub churn out televisions, furniture, toys, and a seemingly infinite number of other products for consumers worldwide. But with China's exports down 15% in September—the 11th consecutive month of decline—Dongguan is reeling. In the Changping district, once dubbed "little Hong Kong," shuttered factories are overgrown with weeds. The karaoke bars and restaurants, which once catered to the thousands of Hong Kong and Taiwanese managers who have fled, are quiet. Sure, the economy of Guangdong Province is on track for 9% growth this year, but that's due mainly to massive government spending on public works, such as an airport expansion and a nuclear power station. "What Guangdong is facing, all of China is facing," says Wang Yiyang, vice-director of Guangdong's development research center, an arm of the provincial government. "We have to find new sources of competitiveness."

HOW TO PLAY IT 068

In response, Guangdong is launching a crash restructuring that the provincial Party boss calls "emptying the cage and changing the birds." Dongguan and eight other Delta cities are moving low-wage factories into new industrial zones 50 miles or more to the north in poorer parts of the province. Greener industries, such as biopharmaceuticals, renewable

energy, and information technology, are to replace them. But hopes for a surge in foreign investment have been dashed by the global recession. So Guangdong is courting state-owned companies from elsewhere in China and pressing local enterprises to become more innovative.

In pockets across the country, officials have made far more progress toward the new economic vision. China is aggressively promoting wind power, greener solid-state lighting, and high-speed trains. Shanghai, Beijing, and dozens of other cities are building vast subway networks to complement the highways already in place. To persuade citizens to spend more and save less, Beijing is expanding public health care and subsidizing small cars and electric appliances. Millions of small private companies have sprouted, and hulking state industries that provided cradle-to-grave benefits have been downsized. Cities and provinces are boosting research spending, retraining workers, and courting investment in new industries such as biotechnology, which is attracting top Chinese scientists from the U.S. "China's growth seems unstoppable," says Rao Yi, a former Northwestern University neuroscientist and now dean of Beijing University's life-sciences school.

NO INCUBATOR OF INNOVATION

China has a long way to go, though, in innovation. The mainland has dramatically boosted research spending and boasts the world's biggest pool of science and engineering graduates. But aside from Internet games, the country creates few breakthrough products, due in no small measure to the perennial problem of rampant counterfeiting. China last year exported $416 billion worth of high-tech goods. But subtract the mainland operations of Taiwanese contract manufacturers and the likes of Nokia, Samsung, and Hewlett-Packard, and China is an electronics lightweight. Beyond Tsingtao beer and low-end Haier refrigerators, "China has zilch brand presence in the U.S.," says Kenneth J. DeWoskin, director of the China Research & Insight Center at Deloitte & Touche. Instead, most mainland companies mine existing technologies and compete on high volume and low cost in commodity goods.

Take cars. For decades, Beijing has sought to shore up the industry. But Volkswagen, Toyota, Buick, and other foreign brands dominate in midsize sedans and SUVs. Domestic carmakers such as BYD Auto, Geely, and Chery have thrived by developing subcompacts that sell for as little as $4,400. They're now China's great hope in electrics and hybrids. Beijing, meanwhile, is ramping up support. To meet a goal of producing 500,000 such vehicles by 2011, the Science & Technology Ministry plans to put 60,000 electric buses and taxis on the streets and offer subsidies to buyers in 13 cities.

BYD Auto has generated the most buzz. The Shenzhen company this year expects to sell 400,000 cars, and its parent is one of the world's largest producers of lithium-ion batteries for mobile phones, PCs, and other gadgets. Next year it plans a U.S. launch for the e6, a five-seat electric plug-in with a claimed range of 249 miles. BYD's stock has rocketed so high that fabled investor Warren E. Buffett's 10% stake already has earned him a paper profit of more than $1 billion. BYD vows to be China's largest carmaker by 2015 and overtake Toyota as the world's leading brand by 2025, producing 10 million vehicles a year—half of them for export.

BYD has a long way to go. This year it will be lucky to match its 2008 export record of 8,000 cars, all sold in Russia and developing nations from Africa to Latin America. It says it has delivered only about 100 of its $22,000 F3DM plug-in hybrids in China this year—far from its sales target of 4,000. BYD's biggest advantage? It's not design, cutting-edge technol-

CRADLE OF A GREEN REVOLUTION

Dalian's experiment in innovation may point the way for all of China

By Pete Engardio
DALIAN

In a nation known for pollution-choked cities and countless smoke-belching factories, Dalian, on China's rugged northeast coast, offers a pleasant respite. Fresh green spaces abound in the hilly city of 6 million that is often compared with San Francisco. Xia Deren, a former university dean and now Dalian's urbane Communist Party chief, waves his arm toward a leafy district of low-rise office buildings outside his window. Fifteen years ago, he says, "the area where we are now sitting was filled with chemical plants." Those factories, and many others that once ringed the city's picturesque harbor, have been shut or relocated, replaced by rapidly expanding software houses, green-technology plants, and service companies that are becoming Dalian's new economic pillars.

Cities from Chongqing in the southwest to Tianjin and Shanghai in the east are attempting similar makeovers. But while Dalian's transformation is hardly complete—just up the coast, a petrochemical company is building a controversial $700 million plant—it may be furthest along in implementing Beijing's vision of the economic future: replacing sooty, low-skill factories with innovative green industries. "We need to change the way our economy grows and embark on a new road of industrialization," says Xia.

Dalian's economy has been propelled largely by companies that do outsourced work for Japan and other Asian neighbors. The city boasts 400 software companies accounting for $1 billion in annual exports and 60,000 jobs—a figure that's expected to reach 200,000 in three years. Oracle, Fidelity Investments, Nippon Telephone & Telegraph, Citigroup, and Minolta have all invested in Dalian, and Intel is building its first Asian silicon wafer fabrication plant just outside the city.

Local officials are pioneering new strategies to spur innovation. They stress collaborations among universities, government





institutes, and private companies in emerging technologies such as solid-state lighting devices, hydrogen fuel cells for cars, and nanomaterials. Dalian's leaders "clearly know what is needed to succeed in the innovation game," says Denis Fred Simon, a Penn State University professor who is helping set up a research center for clean coal technology in the city.

The 33 small business incubators in Dalian may be another key to growth. Modeled after similar initiatives in Silicon Valley, these outfits offer low-cost lab and office space for tech startups and help their founders hone business plans and find investors. "We have a new model of technology transfer from universities," says Liu Xiaoying, the energetic director of the city's science and technology bureau, who wrote her PhD thesis on incubators. "I want everything we fund to focus on products, not research papers."

ogy, or state-of-the-art manufacturing. Instead, it's a fairly conventional battery that BYD manages to produce cheaply. "Making affordable products is key for the development of the electric vehicle industry," says Henry Z. Li, BYD's general manager for international sales. BYD declined a request to tour its factories, but visitors to the company's plants say its batteries and electric motors are hand-assembled by long lines of blue-uniformed workers rather than the robots that have

MARK LEONG/REDUX

Dalian's Liu stresses cooperation to nurture tech startups

become standard in most of the industry. Whether BYD or other Chinese carmakers are anywhere near meeting European and U.S. safety regulations is another question. "In mature markets the barriers are very clear and standards very high," says Yale Zhang, China director for auto consultancy CSM Worldwide.

WESTERN TECHNOLOGY INSIDE

Disassemble other widely hailed successes of indigenous innovation, and there is little Chinese about them. Beijing has long craved its own commercial aircraft industry, and its first offering—a 90-seat commuter jet dubbed the ARJ21—is to hit the market next year. Next up is the C919, a midrange plane with up to 190 seats that state-owned Commercial Aircraft Corp. of China (Comac) unveiled on Sept. 9. The airliner, scheduled for delivery in 2016, is intended as a direct challenge to Boeing and Airbus.

Western experts familiar with Comac's planes say they're based on older jets designed by McDonnell Douglas two decades ago, before the U.S. company was acquired by Boeing. The avionics, engine, and other key systems on the ARJ21, meanwhile, come from Western suppliers such as Honeywell, General Electric, and Rockwell Collins. "China wants to be



Devotion President Ma has shifted his company's focus to biofuels

PAUL HU/ASSIGNMENT ASIA

self-sufficient, producing everything itself," says Nathan K. Smith, aerospace analyst at market research firm Frost & Sullivan. "But it simply doesn't have the capabilities to develop these aircraft without Western technology." The prospect of Comac competing with Boeing and Airbus outside China even two decades from now, says Smith, "is a long shot." Comac declined interview requests.

Some Chinese industrial policies have flopped. Beijing has long viewed semiconductor manufacturing as a key industry, for example, and eight new silicon wafer plants—some heavily subsidized—have been built just since 2005. The aim was to start out competing as low-cost contract manufacturers for foreign chip design firms. But China's wafer factories rely on technologies that are at least two generations behind those of Taiwan, the U.S., Japan, and South Korea, and few have ever been profitable. At the nadir of the recession last winter, 60% of China's capacity sat idle. But with next-generation wafer plants costing $3 billion and up, a major shakeout looms, says Len Jelinek, semiconductor analyst for market research firm iSuppli. "Most Chinese companies don't have the technology and the money to invest in research and development to stay in the game," he says.

Of course, China has plenty of smart entrepreneurs who are steering their companies in new directions. They're tapping the mainland's engineering talent, stressing design, and reorienting old-line manufacturing operations to unearth new opportunities. Guangzhou's Devotion group typifies the shift. The 17-year-old company's primary business—making huge diesel-fired boilers for factories and big buildings—has been hit by the slowdown, rising fuel costs, and growing government efforts to reduce air pollution. Sales plunged 45% in the first half, and its Singapore-listed shares trade below their 2003 offering price.

So Devotion has shifted its focus to biofuels and the boilers that burn them. Outside its headquarters are piles of broken wooden pallets, containers filled with corn and rice husks, a patch of elephant grass (a fuel source that can grow 10 feet high in a few weeks), and a hulking refinery that turns such materials into biogas, oil, and flammable pellets. Devotion offers to install boilers for free and says it makes its money on long-term contracts to sell the biofuels. The company says it now has 30 biofuel customers and aims to triple sales, to $600 million, within five years, with most of the increase coming from new-energy products and services. But with diesel boilers accounting for 90% of sales, it will have to ride out tough times. The biofuel business "is still small," concedes Devotion's burly president, Ma Ge.

Given China's many signs of progress, it's easy to forget that it remains an underdeveloped economy facing huge challenges. Yes, it has an immense, youthful population, gifted entrepreneurs and scientists, ambitious officials—and lots of money. So it's likely Beijing will someday get the formula right. But China's economic reforms are now three decades in the making. That's several years longer than Mao Zedong and his loyalists spent imposing their extreme brand of socialism. "Japan and South Korea took 30 years to make a similar transformation" to an economy driven by innovation, consumer spending, and services, says Guangdong Academy of Social Sciences economist Ding Li. "Our expectations can't be too high." But expectations of China's arrival as a superpower already are high both at home and abroad. The longer Beijing waits to update its tired growth formula, the longer it will take for China to fulfill that destiny. |BW|

–With Huang Zhe in Beijing

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

Increasing Protectionism

In separate papers published this autumn, the U.S.-China Business Council and the European Chamber of Commerce in China both identified rising protectionism and economic nationalism as pressing concerns for foreign companies doing business in the mainland. Some markets are effectively closed to international investors, while in others, laws and regulations are selectively enforced to favor domestic companies at the expense of foreign-owned rivals. And while China's immense stimulus package has created opportunities for a few foreigners, especially those involved in infrastructure, most of the funding has gone to mainland companies.

To view the papers, go to **bx.businessweek.com/china-business/reference/**


TIMIDITY DIDN'T GET YOU THIS FAR. WHY PUT IT IN YOUR BUSINESS PLAN NOW?
In today's corporate world, pity the poor executive who blinks. The good news is, in trying times like these, fortune tends to favor those who make bold, decisive moves. It's simply about adjusting, not retreating, starting with a good, hard look at your flight department. Are you flying the right aircraft for your missions? Can you adjust capacity to meet demand? One thing is certain: true visionaries will continue to fly. Because, in tempestuous times, leaders recognize it's not about ego. Or artifice. It's simply about availing yourself of the full range of tools to do your job.
RISE.
May we help you develop your plan?
Visit www.week.cessna.com or call 1.877.637.2670.
Cessna
A Textron Company


THE
APP
ECONOMY

By Douglas MacMillan, Peter Burrows, and Spencer E. Ante
Illustration by Ray Bartkus

Goofy games get most of the hype and make a lot of money—but there's much more to this surging market



It's easy to shrug off the kooky world of apps. The bite-size software programs people load onto their mobile phones or tap into on the Web seem mostly to be silly games and pointless novelties. But look past the beer-drinking apps and flatulence programs and you'll see something significant taking shape: a bustling app economy that's creating new fortunes for entrepreneurs and changing the way business gets done.

It's happening with dizzying speed. Just two years ago, almost none of this existed. Apple's App Store, the most popular destination for mobile-phone programs, was launched last summer. Now there are more than a dozen rival stores, and at least 100,000 apps have been created. Some startups that staked their claim in the app economy have become large, lucrative businesses in just a few months. Two-year-old Zynga, which makes popular game apps, is already profitable, with more than $100 million in revenues. By comparison, Google didn't start making money until its third year—and still had less revenue.

There are serious business tools among the thousands of new apps. Salesforce.com's programs let executives manage customer relationships from an iPhone or BlackBerry. Oracle apps let managers check inventory or get a snapshot of a business unit's performance. The computing that people used to do at their desks increasingly can be done on devices they can carry anywhere.

EARLY DAYS

Apps will help determine technology's next big winners. The success of Apple's iPhone is due in large part to the fact that the company can offer customers more software choices than any rival. Research In Motion, maker of the business-oriented BlackBerry, has scrambled to catch up and has made progress. But established giants such as Nokia and Microsoft are struggling to get traction, raising questions about their prospects.

These are such early days, no one knows exactly how big the app economy is. Companies make money from selling apps, from ads within apps, and from selling digital goods used in apps. Add it up and analysts figure it's at least a $1 billion market today, headed for $4 billion by 2012. Not bad for a brand-new business.

True, much of the money these days comes from goofy games. One popular app is I Am T-Pain, named after the performer, born Faheem Najm. Fans can download software to their iPhone and mimic his robot-like voice. But it's time to heed the opportunities in this fast-evolving world. The $2.99 T-Pain app has put its creator, a year-old startup called Smule, on track to pull in $3 million this year. "Apps have moved into the mainstream. The world's changed," says Jeff Smith, Smule's chief executive.

ZYNGA'S ZING Revenues are soaring on the success of 'social game' apps like FarmVille

Early this year, Marc Pincus, founder of the tech startup Zynga, huddled with staffers in his company's San Francisco offices to brainstorm new product ideas. Zynga develops game apps that can be played on social networks such as Facebook or mobile phones like the iPhone, and Pincus needed a follow-up to a popular poker app. One employee suggested a farming game, where players could grow digital crops and sell them to make virtual money. Pincus liked the idea and gave it the green light. Four months after its launch, FarmVille is one of the most popular apps in the world, with 60 million people playing it in the last month. "It just exploded," says Pincus.

Such is the nature of business in the burgeoning app economy. Success—and a flood of money—can arrive practically overnight. Zynga doesn't charge users to play FarmVille, but it does sell digital crops, cattle, and farmland. Corn seed, for instance, goes for the equivalent of 10¢; cows run 20¢ each. All those digital goods add up. Zynga pulls in its nine-figure annual revenues from FarmVille and 20 other games.

The company may be just getting started. U.S. revenues from so-called social games have surged over the past two years to $720 million, and analysts project they will grow to $2 billion by 2012. "We are seeing very strong success with these companies," says Atul Bagga, an analyst with investment bank ThinkEquity. "They are basically letting customers choose [how much money] they want to [spend] in a particular game or application."

Zynga has the vibe of a young Google. Just like

POPULAR APPS FOR BUSINESS

A digital briefcase for workers on the go

LINKEDIN

Availability: iPhone, Palm

Cost: Free

Forget business cards; connect with people on the largest professional social network the moment you meet them

PROONGO

Availability: BlackBerry, Windows Mobile

Cost: Free

Keep a log of travel expenses plus photos of receipts; e-mail the report to your desktop

FEDEX MOBILE

Availability: iPhone

Cost: Free

Track shipments' status and get updates when they arrive

SALESFORCE MOBILE

Availability: BlackBerry, Windows Mobile, iPhone

Cost: Free for Salesforce customers

Monitor sales leads and accounts from the field

DOCUMENTS TO GO PREMIUM

Availability: BlackBerry, Android, iPhone, Palm, Windows Mobile

Cost: $10 to $70

Create and edit documents in Word, Excel, and PowerPoint. Even has a spellcheck

the search giant in its early days, the company has a masseuse on staff and chefs who serve up two meals a day to keep employees from wasting time going out for food. It has weekly keg parties, like the ones Google's founders once hosted. And Pincus has tried to maintain a light atmosphere, even as the company has grown to 468 employees. The winner of a monthly poker tournament gets treated to a one-day Lamborghini rental. Pincus calls the atmosphere "ghetto Google."

SEEDS OF SUCCESS

The company's offices are in the industrial Potrero Hill neighborhood of San Francisco. On a recent October day the 43-year-old Pincus, clad in jeans and an untucked oxford shirt, drew three intersecting circles on a whiteboard. He says the next great opportunity on the Web lies at the intersection of three trends—apps, Web services, and small online payments from consumers. Pincus sees apps not as products but as ongoing services that users tap into from Facebook or the iPhone and pay for in small increments. "Our story has been about finding games people could play forever and giving them a reason to do it," he says.

The strategy is in full swing in the FarmVille studio at Zynga, where a 30-person crew manages the company's biggest hit to date. The game is an odd success for the digital world: Users get a virtual plot of land to farm as they see fit. As they grow crops and earn currency, they can use the money to buy more seeds, animals, and tools like tractors. Since all players are logged in to Facebook, they can work with friends or co-workers, or they can compete against them for farmer bragging rights. There are roughly 20 times more people playing FarmVille these days than there are actual farms in the U.S.

For a hit like FarmVille, the work is never done. A wall-size chart in the FarmVille studio lists the various virtual items up for consideration in the next round of improvements to the game, culled from staff ideas and requests from users. The ability to get feedback and act on it quickly is a break from past models, says Mark Skaggs, who runs the FarmVille group. At large companies such as Electronic Arts, where Skaggs used to work, "You might design a feature and not know until two years later whether it was good or people liked it," he says. "Here, you can design a feature in a day and put it in the game the next day."

As Zynga's games have grown, they've become giant test labs for new ideas. "Every single click is being recorded," says Vish Makhijani, Zynga's chief operating officer. That means Zynga can quickly find out the impact of small adjustments—such as changing the size of a cabbage



Pincus calls his company, which rewards workers generously, a "true meritocracy"

PHOTOGRAPH BY ERIC MILLETTE

patch in FarmVille or the cost of a new gun in the game Mafia Wars—on retaining users and increasing revenue. One recent success: digital sweet potato seeds that cost $5 a packet. The seeds, which of course cost nothing to duplicate, pulled in more than $400,000 in three days.

The rich opportunity has fueled aggressive competition. Zynga's primary rivals are London's Playfish and Mountain View (Calif.)-based Playdom. Playfish is known for a game called Pet Society, which lets people adopt online creatures and then dress them up in designer clothes, while Playdom's hit game is Mobsters, in which people try to gain skills, alliances, and wealth. All three companies are private and don't disclose financial information.

The game makers compete for users across all sorts of technology platforms. The big targets are Facebook, with more than 300 million members, and Apple's App Store, with more than 50 million iPhone and iPod touch users.

Lately, Playdom and Zynga have also been dueling in court. A lawsuit filed by Zynga in September alleges that several former employees recruited by Playdom supplied the competitor with the Zynga Playbook, a proprietary document the complaint



describes as "the recipe book that contains Zynga's 'secret sauce,'" referring to its game-making techniques.

The rapid growth and sharp rivalries have drawn comparisons to the early days of Web pioneers such as Amazon.com and eBay. One significant difference is that the apps business has virtually no barriers to entry, meaning it is hard for any company to maintain a lead. Today there are thousands of small developers who crank out apps that don't make a dime.

The perk-heavy culture at Zynga is certainly reminiscent of the dot-com days. Inside its office for human resources, 160 small paper bulldogs are tacked on the wall, one for every new hire in the past quarter. There's a cooking staff of 17, and most game studios have their own kitchen. Several rooms are equipped with Xboxes and board games, and are designated "meeting-free areas."

NEW STAFFERS AND A COUCH

With employees grouped into a series of discrete loft offices, Zynga's operation looks more like 11 small startups glued together than one large one. It's a reflection of how the company is run: Studio heads set goals and are given freedom to achieve them any way they can. Those who succeed are rewarded with cash and stock bonuses and are granted extra resources such as new hires. When a new game called Café World recently set a company record for growth, signing up 16 million users in its first two weeks, its head, Roy Sehgal, was rewarded with a bevy of new employees and the leather couch he had been requesting for his office for weeks.

Pincus calls this style of management "true meritocracy" and says it's modeled partly after the approach at Amazon. It applies to regular staffers as much as managers. In his first three months in the poker group, Harsimran "Sim" Singh moved up the company ladder three times for helping to bring growth back into the company's longest-running game, Texas Hold'em. A year after landing at Zynga with no direct reports, the 25-year-old runs the entire poker unit, a team of 45.

The Amazon influence affects how Pincus conducts his board meetings. Each time he meets with his directors, he begins by recounting whatever issue kept him awake the night before. It's a tip he learned from Amazon CEO Jeff Bezos, an acquaintance and role model who shares a director with Zynga.

One matter getting airtime at board meetings of late: When should the company consider going public? Zynga doesn't need cash. It raised $39 million in venture capital in 2008 and hasn't touched the money since. But a publicly traded stock would give Pincus the currency to make deals or dole out employee options. Still, Pincus wants to protect the culture he has created. "We all make so many compromises in order to build our businesses that we wake up one day and we've created a company that we don't want to work at," he says. "I wanted to create a long-term home."

THE APP IN APPLE How Eddy Cue and his team keep the App Store out in front

If you had to choose one person who makes the world of apps go around, Eddy Cue might well top the list. Apple's vice-president for Internet services is the architect and overseer of Apple's App Store. Millions of iPhone owners have downloaded the 85,000 apps available from the App Store. That's light years ahead of rival offerings from Google, Microsoft, or Research In Motion.

Cue and his team seem on track to ensure that those mobile Internet wannabes don't close the gap anytime soon. While no rival has even 15,000 apps, his team keeps tweaking Apple's offerings to make them more attractive to consumers and useful to developers. On Oct. 14, for example, Apple told developers that for the first time they could give away apps on a trial basis and then ask consumers to pay later. "Apple has done a ridiculously good job, and now they're taking it to the next level," says Jeff Holden, chief executive of Pelago, which makes apps for the iPhone and other devices.

Cue, 45, joined Apple as a lowly staffer in the IT department, in time to witness the company's darkest days during the mid-1990s. He not only survived a major housecleaning after

MILLION-DOLLAR APPS

While many apps are free, folks have paid up for these



ENIGMO
Sales: $2.5 million
Company: Pangea
Navigate water mazes by pinching, dragging, and dropping



F.A.S.T.
Sales: $1.8 million
Company: SGN
Engage in aerial combat on your phone



OCARINA
Sales: $1.3 million
Company: Smule
Turn any iPhone into a woodwind instrument



ROLLER-COASTER RUSH
Sales: $1.1 million
Company: Digital Chocolate
Tilt a cart through loop-the-loops and steep drops



FLICK FISHING
Sales: $1 million
Company: Freeverse
Cast a line by waving your phone in the air, then reel 'em in



Data: Company reports

(BOTTOM) ILLUSTRATION BY RAY BARTKUS

APPS FOR BEGINNERS

Got a new smartphone? These downloads are essential

YELP

Availability: BlackBerry, iPhone, Palm

Cost: Free

Find local food, bars, and shops rated by the community

FLIXSTER

Availability: Android, BlackBerry, iPhone, Palm

Cost: Free

Check movie showtimes, read reviews, and watch trailers

AMAZON MOBILE

Availability: Android, BlackBerry, iPhone

Cost: Free

Compare the price you see in a store to Amazon's, in a flash

CNN MOBILE

Availability: iPhone

Cost: $2

Watch the news outlet's live video coverage from your mobile phone

TETRIS

Availability: Android, iPhone

Cost: $8 to $10

Kill time on the commute or at the dentist with the classic puzzle game

Steve Jobs returned to the company as chief executive in 1997 but emerged as one of the CEO's most trusted lieutenants. When Apple found itself playing catch-up in digital music early this decade, Jobs put Cue in charge of creating the iTunes Music Store. While far less ambitious efforts floundered, Apple's site was doling out millions of songs within weeks, with nary a hitch.

HOLLYWOOD CONNECTION

Over time, Cue's role expanded from running the iTunes store to cutting deals to fill it. While Jobs often finalizes agreements, Cue does most of the heavy negotiations with record labels and Hollywood studios. "Eddy doesn't have attitude. That's part of his success," says one former Apple insider. "In an industry with lots of big egos, he can hold his own without saying, 'I'm the inventor of iTunes, bow before me.' " One favorite approach is for Cue to "play good cop to Steve's bad cop," says the ex-employee. Apple declined to comment for this story.

Cue stands out within Apple's hard-core culture for his friendly, let's-get-a-beer manner. A rabid Duke University basketball fan, he's described by insiders as an "East Coast guy's guy." But he's one of a tight-knit group that makes sure that Apple devices, software, and services work smoothly together. Many app developers don't know the role he plays or even his name.

No doubt Cue has his hands full with the fast-growing App Store. When Apple rushed plans for the store into place in 2008, it was overwhelmed by the customer interest. The company had to invent the business on the fly, including how to approve and promote applications. Now Apple's back-end infrastructure may be as indispensable a competitive advantage as the iPhone's design. Developers have flocked to Apple because they see how the App Store can make huge successes of programs like Shazam and Tap Tap Revenge.

Apple's success has led to controversy. Some developers gripe about delays in getting into the App Store, and the Federal Communications Commission is investigating Apple's refusal to approve an application from Google. Analysts say Apple needs to develop better ways for customers to find just the right app among the thousands of options—and thereby make the business more profitable for more developers.

Still, most developers give Apple and Cue high marks. They not only established the App Store but also are building on its success. "Apple is really listening to the marketplace," says Shervin Pishevar, CEO of app developer Social Gaming Network.



ENTER YAHOO The company is out to become the go-to place for applications

Yahoo! has big plans for apps. While Apple may have started the app phenomenon by letting developers create programs for the iPhone, but Yahoo wants to be the company that brings apps to the wider world.

In the company's most ambitious app effort to date, Yahoo is redesigning its home page to include applications from outside developers. As the changes roll out through November, the apps will be listed along the left-hand side of the Yahoo.com page, used by more than 300 million people each month. Visitors can customize their own home pages, selecting the apps they want. Then they can check the day's headlines from *USA Today* or bid for an item on eBay without leaving the Yahoo site.

Yahoo will make money from advertising embedded within the apps. It's also considering launching its own app store, similar to Apple's, in which case it could charge for applications and split revenues with developers.

This is only one of the app frontiers Yahoo is exploring. The company has developed software for televisions that lets people launch applications such as Twitter and Facebook on the TV screen while watching their favorite shows. Another new technology allows people to tap into apps directly as they use Yahoo! Mail. Wherever people are, Yahoo wants to "summon up a gal-

ILLUSTRATION BY RAY BARTKUS



lery of all the possible things you could do," says Prabhakar Raghavan, head of Yahoo's research division. "Here are 50 million things you could do—book a ticket, upload a picture. Everything's an app."

Yahoo's home page strategy is getting some traction. Dozens of software developers have signed up and landed their programs in the "App Gallery," a menu from which users can pick and choose their favorite free programs. Carrie Cronkey, the director of business development at personal finance site Mint.com, says people are more likely to join Mint if they're referred by Yahoo because it implies a level of security. "The fact that [your app] is on Yahoo makes you more credible," she says.

For Yahoo, the real payoff from sprinkling apps into TVs and its home page comes in the form of data. By tracking which apps people use and how they interact with them, the company is building on its ability to serve targeted ads. That may help the company compete for ad revenues against rivals such as Google. "Apps can play a big role in understanding user behavior," says Raghavan.

GOLD RUSH? Money is flowing into apps as smartphones reshape the tech world

When Bart Decrem went looking for office space in the spring of 2008 for his startup, Tapulous, Jeff Clavier opened his door. Clavier, the founder of venture capital firm SoftTech VC, saw enormous potential in the Tapulous software that would run on Apple's iPhone. So he let Decrem use some space in the firm's Palo Alto (Calif.) digs and made an investment in his company.

Eighteen months later, Clavier's support of Tapulous looks like it may be one of his best investments ever. The company's Tap Tap Revenge app, in which players tap on-screen balls in sync to the beats of a song, has become a breakout hit. The game and its multiple spin-offs have been downloaded more than 15 million times. Tapulous, which makes money from game sales, advertising in the game, and the sale of in-game avatars, has been profitable since this summer, a speedy accomplishment for a tech startup.

The investment has convinced Clavier there is loads of potential for venture capital investments in mobile applications. At last count, consumers had downloaded 2 billion programs from Apple's App Store, and that's just one place among several where people get apps. Clavier believes app startups could become billion-dollar outfits that rival traditional game and software companies. "The revenues of these companies will become substantial," he says. "There will be publishers that become large brand names."

"WE SEE HUGE MARKETS"

The torrid growth has attracted money from other high-profile investors. Last March, Kleiner, Perkins, Caufield & Byers, one of the Valley's marquee venture capitalists (page54), launched a $100 million investment fund specifically to back startups creating software applications for the iPhone. Last October, Research In Motion unveiled a $150 million venture fund, with investments from Thomson Reuters and RBC Venture Partners, to develop apps and services for its BlackBerry and other phones. And this October, U.S. mobile operator Verizon Wireless announced an initiative to invest up to $1.3 billion in wireless applications and related technologies. "We see huge markets and game-changing opportunities," says Kevin Talbot, co-managing partner of the BlackBerry Partners Fund.

Of course, investors don't need a dedicated fund to participate. Firms such as Union Square Ventures, O'Reilly AlphaTech Ventures, and XG Ventures are devoting an increasing amount of time and money to financing wireless apps. "Most of the deals we see are in the mobile arena," says Andrea Zurek, co-founder of XG Ventures, a new VC firm of former Google executives.

The money flowing into apps is inspired by the belief that smartphones and other portable devices are transforming the tech world. The growth of mobile computing is sparking a renaissance in software development. Gaming apps are the most popular programs right now, but mobile shopping, content, social media, communications, and productivity tools are attracting increasing amounts of capital. "We don't think this is slowing down anytime soon," says Matt Murphy, the partner at Kleiner Perkins running the fund dedicated to Apple-related investments. |BW|

POPULAR FREEBIES

Slick smartphone apps that won't set you back

ESPN SCORECENTER

Availability: iPhone

Scores and play-by-play for every major sporting event, plus stats and schedules for your favorite team

FACEBOOK

Availability: Android, BlackBerry, iPhone, Nokia, Palm, Windows Mobile

The world's largest social network in your pocket. Also, upload pictures using your camera phone

OPERA MINI

Availability: Android, BlackBerry, Nokia, Windows Mobile

The world's fastest mobile Web browser

PANDORA

Availability: Android, BlackBerry, iPhone, Palm, Windows Mobile

Net radio at its smartest: Type in a couple bands or songs you like, then hear a playlist of similar tunes

TAP TAP REVENGE 2

Availability: iPhone

A game that tests the rhythm in your fingers

COUNTRY REPORT

DEBT WATCH IN DUBAI

By Stanley Reed
Photograph by Thomas Ebert

The flashy city-state's companies owe 126% of GDP, and the main hope for salvation is Abu Dhabi





On a sultry fall evening in Dubai, Mohamed Ali Alabbar proudly shows visitors the artificial lake surrounding the nearly completed Burj Dubai, at more than 2,600 feet the world's tallest building. As an Andrea Bocelli recording plays *Time to Say Goodbye* over the sound system, water sprays high in the air. Alabbar, chairman of Emaar Properties, Dubai's top real estate developer, explains how the fountains were designed to outclass similar waterworks at Las Vegas' Bellagio hotel and casino and cost more than $250 million. "I said to make it 20% better" than the Vegas version, he recalls.

Bigger. Faster. Taller. Better. For the last decade Dubai thrived on this I-want-it-now credo as the Gulf emirate turned itself into a premier business hub. Today construction crews still labor on Dubai's skyscrapers and malls, and the bars at swank hotels like the Fairmont and the Emirates Towers are packed. Yet Dubai Inc.—that collection of state agencies and state-backed companies that has powered the city forward—now faces a debt crisis as scary as anything that threatened the banks of the U.S. and Europe. It has to pay back or refinance almost $50 billion in four short years. Dubai's ability to pull that off now depends very much on outside bankers—and especially on the largesse of Abu Dhabi, the nearby oil-rich emirate that has long looked on Dubai with a mix of admiration, disapproval, and envy.

The key cluster of Dubai companies owes as much as $90 billion, or 126% of gross domestic product, much of it in short-term bonds and loans from the world's top banks. Dubai could get away with so much borrowing as long as real estate and other asset prices kept rising. But they crashed. Its residential real estate prices have fallen over the past year by a world-leading 47.5%, while office rates are also way off except in the choicest areas. Office and hotel space keeps piling up as the government of heredi-

LAIF/REDUX



tary ruler Sheikh Mohammed bin Rashid al Maktoum presses developers to finish their projects. Dubai officials would not comment for this story.

Dubai's debt workout is reaching a pivotal moment. The most immediate concern is a $3.5 billion *sukuk*, or Islamic bond, issued by Nakheel, a branch of investment company Dubai World. Nakheel, which is building the spectacular palm-shaped artificial islands off the emirate's coast, must pay bondholders back or refinance by yearend. Further out, Standard & Poor's figures that Dubai must pay off or refinance a total of $47.4 billion by mid-2013. Regional investment bank EFG-Hermes estimates key Dubai companies have $13.1 billion in debt due in 2010 alone.

Farouk Soussa, an S&P analyst in Dubai, figures the emirate has only $3 billion to $4 billion left of a $10 billion loan it obtained from the United Arab Emirates central bank earlier this year. Meeting the payments "is not going to be easy or comfortable," he says. The $10 billion Dubai borrowed earlier this year was supposed to be just the first half of a $20 billion financing program, a mix of central bank loans and publicly issued bonds.

Palm Jumeirah: Its developer has $3.5 billion in bonds coming due by yearend

While spreads on Dubai debt are narrowing, bankers say there is little appetite in the debt markets for more Dubai paper. What gives investors pause is that they have not yet heard a clear plan from Dubai on how it is going to clear out the debt. "It is likely that Dubai will be unable to access fresh funding for quite some time," says Simon Williams, chief Middle East economist for HSBC in Dubai. The most likely source of the next $10 billion is up the road in Abu Dhabi, the largest and wealthiest emirate in the U.A.E., about an hour's drive northeast of Dubai. A major oil producer, Abu Dhabi has several hundred billion in cash and investments and no debt problem at the moment.

Abu Dhabi may prove a tough lender. Financial sources say its leadership, which in effect underwrote the $10 billion Dubai borrowed earlier this year, is not thrilled by the prospect of writing big checks to its profligate cousins in Dubai. Abu Dhabi has a corps of financial professionals at a web of funds that invest the bulk of the emirate's surpluses. Sources say these pros are pushing Abu Dhabi's leaders to insist on hard terms

in exchange for fresh funding. One idea is for Abu Dhabi to take stakes in Dubai's crown jewel companies, such as Emirates Airlines, ports operator DP World, and Dubai Aluminum. Such deals could consolidate these companies with their Abu Dhabi counterparts, such as Etihad Airways.

BOTH ABU DHABI AND QATAR ARE BUILDING FINANCIAL HUBS AND ARE POISED TO TAKE ADVANTAGE OF DUBAI'S STUMBLES

So far, Dubai's Sheikh Mohammed has shrewdly fended off any grab of Dubai's equity. This summer he even pulled the plug on a sale of about 20% of DP World for some $2 billion to Abraaj Capital, the Dubai private equity firm, and China Investment Corp., Beijing's sovereign wealth fund.

FAMILY TIES

Dubai's leader has other cards to play. A debacle in Dubai would shake investor confidence in the entire U.A.E., Abu Dhabi included. The other emirates cannot let that happen. Moreover, the Abu Dhabi potentates have close ties to Dubai through everything from hotel investments to marriage. Sheikh Mansour bin Zayed Al Nahyan, for instance, who recently made $2 billion selling his stake in Britain's Barclays bank and is considered the third most influential member of Abu Dhabi's royal family, is married to the Dubai sheikh's favorite daughter. "You can be sure Sheikh Mansour hears about this every weekend when he visits the palace," says a banker. A possible compromise: a mortgage held by Abu Dhabi on Dubai assets that would let the emirate regain equity if and when it pays off its obligations.

The debt overhang, meanwhile, is putting a damper on the economy. Credit may get even tighter for local businesses: As Dubai Inc. pays off foreign creditors, it will probably lean on local banks to shoulder larger shares of the debt burden. And despite his political skills, Sheikh Mohammed has lost stature in the U.A.E., especially with the Abu Dhabi elite. Both Abu Dhabi and gas-rich Qatar are following Dubai's example in building financial hubs and are poised to exploit its stumbles. If Abu Dhabi, which is more conservative than Dubai, ends up calling more of the shots on U.A.E. policy, it could force Dubai to tighten rules on the immigrants who bring in money and do much of the work. It could also push Dubai to crack down on the bars and clubs that offer a competitive edge for the freewheeling emirate. Abu Dhabi officials declined to comment.

The best thing Dubai can do now is recover its fast pace of growth. Recently a visitor, stuck in traffic in the financial district, phoned a banker's secretary to say he would be late. "That's great," she said. "Things must be getting better." More seriously, lower office rents help companies, and hotel rooms that once fetched $600 a night can be had for a third of that, making Dubai an affordable destination once more. It's still the place to discuss any business having to do with Iran or Saudi Arabia, which sport few amenities. "As long as conditions in Saudi Arabia remain hard, Dubai will thrive," says Khaled Al-Muhairy, CEO of Dubai fund management firm Evolvence Capital.

Can Dubai change? Many see the forced slowdown as a chance to plot a more restrained course. "This is an opportunity to do things differently," says Tarik Yousef, dean of the Dubai School of Government. That means, first of all, whittling down that debt. |BW|



Sheikh Mohammed is fending off any grab of the emirate's equity

KLAUS-DIETMAR GABBERT

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

Demystifying Dubai

Visitors to Dubai can nowadays dine out on lobster and champagne, but during a famine in the 1940s residents of the emirate subsisted on locusts and leaves. In *City of Gold*, published this fall, journalist Jim Krane chronicles Dubai's journey from backwater to boomtown in rich and fascinating detail.

To read a review of the book, go to **http://bx.businessweek.com/dubai-business/reference/**



Introducing Xerox ColorQube, color prints are now 62% cheaper.

The new Xerox ColorQube™ multifunction printer cuts the cost of color prints by up to 62% compared to traditional color lasers, without compromising on quality. And with Xerox unique cartridge-free Solid Ink technology, it's not only easy to use, but also reduces waste by 90%. What's more, this high-performance line of MFPs can handle the busiest work environments. So now you can print in color without going into the red.

1-800-ASK-XEROX
FinallyColorIsLess.com



Ready For Real Business xerox



©2009 XEROX CORPORATION. All rights reserved. XEROX®, ColorQube™, the sphere of connectivity design and Ready For Real Business are all trademarks of XEROX CORPORATION in the United States and/or other countries. Savings based on 2009 Gap Intelligence data.

056 Tough love, lower health costs
058 Who fears an emissions tariff
060 Credit eases for entrepreneurs
062 Europe Inc. targets price fixers
063 Why all eyeballs are on CBS
064 India's jet setters opt for coach
065 Boeing's lucky laid-off

Who Will Be the Green VC Giant?

Former Silicon Valley allies are going head-to-head to pick the startups aiming to revolutionize clean tech

By Aaron Ricadela

For nearly two decades, John Doerr and Vinod Khosla worked together at Kleiner Perkins Caufield & Byers, forging one of the most lucrative partnerships in the venture capital business. The gravel-voiced Doerr scored the high-profile hits, including Netscape Communications, Amazon.com, and Google, while the confrontational Khosla backed little-known communications equipment startups such as Juniper Networks and Cerent, with similarly explosive returns.

Now the former colleagues are competing to fund the most promising startups in clean technology, a potentially lucrative but risky field many believe could lead to Silicon Valley's next boom. Doerr, still at Kleiner, helped shift his firm's focus from information technology to green investments a few years ago, with help from partner Bill Joy, former chief scientist at Sun Microsystems. Khosla, who left Kleiner five years back, just raised $1.1 billion from partners and institutional investors, giving his Khosla Ventures the heft to compete for the most capital-intensive deals.



"These guys are in a race" for the most important green deals, says Paul Deninger, vice-chairman at investment bank Jefferies & Co.

Kleiner is the established giant. The firm has raised a total of $5.9 billion since its founding in 1972 and, in addition to Doerr's hits, helped launch America Online and Genentech. Still, the firm is a relative newcomer to green investing. Khosla has been dabbling in such deals since he started his outfit in 2004. With his fresh capital, he is on the hunt for the most ambitious startups. "Our specialty is risk," says Khosla. "Forget [hitting] singles. Lay it out there and take a swing. You may not get a very high percentage of hits, but you get a high slugging percentage."



Khosla's approach is to winnow losing ideas quickly before they consume too much cash, gambling that the surviving startups can score big. Whereas most venture capital firms budget for product-development milestones by the companies they invest in, Khosla Ventures uses metrics that forecast how much it will cost for startups to remove technical risks, tackling the toughest problems first. "We've developed a few tricks," says Khosla.

Take Calera, a startup launched by Stanford University. Its goal is to reduce emissions by making cement that traps CO_2 gas during manufacture. Khosla figures there's a 10% chance his firm can make 100 times its eight-figure investment and a 90% chance the company will fail. That's precisely the kind of prospect that draws his attention. "Sometimes we tell an entrepreneur, 'Your project does not have enough risk for us,' " he says. "They look at you kind of funny."

Doerr started steering Kleiner away from IT and toward green tech a few years ago

Many of the startups Khosla has backed aim to collect power from the sun, harvest it from the wind, or extract it from the earth. Soladigm makes glass windows that can lighten

LYNN GOLDSMITH/CORBIS



ROBERT GALBRAITH/REUTERS

Khosla, who has raised $1.1 billion, is positioned to compete for most any VC deal

or darken to heat or cool rooms, and GreatPoint Energy converts coal into natural gas. Others are trying to invent more efficient motors and batteries. EcoMotors International in Troy, Mich., for instance, makes light, powerful diesel engines.

Kleiner is making similar investments. Its deals include hybrid sportscar maker Fisker Automotive, smart grid company Silver Spring Networks, and Bloom Energy, which is developing a fuel cell that can convert natural gas into hydrogen fuel.

Both companies say this is a friendly competition. In fact, Khosla and Kleiner have co-invested in several deals. "I spend more time with [Doerr] now than I did when we were at Kleiner," Khosla says. Still, he acknowledges that both want to be first to find and build the world's most influential green-tech startups.

The competition could help speed the development of green technologies. Although the industry is perceived to be full of promise, it's fraught with challenges, too. The field is marked by high startup costs, powerful customers and competitors, and government regulations that can change unpredictably. Venture capitalists scaled back their clean-tech investments during the downturn, putting $1.6 billion into such startups during the first three quarters of 2009, vs. $3.1 billion during the same period in 2008, according to PricewaterhouseCoopers and the National Venture Capital Assn.

So far this year only two North American clean-tech companies, Canadian geothermal outfit Magma Energy and battery maker A123 Systems, have gone public, and there have been just nine acquisitions worth more than $10 million in the market, according to investment bank Jefferies. Funding energy companies "is a difficult and new experience for many VCs," says Adam Grosser, a general partner at venture firm Foundation Capital.

Both Khosla Ventures and Kleiner have made losing bets. The firms invested in ethanol maker AltraBiofuels, which late last year closed one factory and suspended production at another after raising $170 million. Ethanol producers have stumbled due to overproduction and demand that declined as the price of gasoline fell. Khosla Ventures wrote off the investment and lost money. "If people want instant gratification, they're going to be disappointed," says Ted Schlein, a managing partner at Kleiner Perkins.

Patience may well pay off. Entrepreneurs say Khosla, now that he has deep pockets to go along with his aggressive investment approach, could help develop a new generation of green startups. "[Vinod] can add tremendous value by giving people very direct advice about what does or doesn't make sense," says Andy Bechtolsheim, who co-founded Sun with Khosla in 1982 and is now chief executive of startup Arista Networks. "He wants to bet not just on significant ideas, but ideas that can change the world." |BW|

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

Safer Bets
Not every VC hoping to profit from green tech supports capital-hungry startups out to displace Big Oil. Sequoia Capital and Foundation Capital back startups that use sensor networks, software, and other info tech to make buildings and data centers more efficient. In a 2009 feature, *The New York Times* looks at the trend.

For the full story, go to **bx.businessweek.com/venture-capital**

Tough Love, Lower Health Costs

A UnitedHealthcare plan offers incentives to employees who strictly control their diabetes

By Arlene Weintraub

A few years back, Dr. Robert S. Galvin was desperately searching for new ways to control medical costs at his company, General Electric. Galvin is GE's chief medical officer. It's his job to keep the company's 323,000 workers healthy. But he was growing frustrated with the challenge: Too many employees with chronic illnesses such as diabetes were not taking their medications or following other prescribed treatment plans, and that led to serious—and expensive—complications. "I said, 'We need to innovate around managing costs,'" Galvin recalls.

One of GE's major benefits providers, UnitedHealthcare, was thinking along the same lines. So last year, United introduced the Diabetes Health Plan, a first-of-its-kind benefit now in pilot testing at GE and two other companies. Fifteen more workplaces plan to roll it out in 2010. This is far more than a "disease management" program where patients sign up to receive, say, discounts on medications but are left to fill the prescriptions themselves. The diabetes plan requires patients to adhere to treatment and drug guidelines and to agree to be tracked by the company to ensure they are compliant. Those who stick with it receive significant discounts on out-of-pocket expenses such as co-pays for diabetes-specific treatments. Those who don't are kicked out of the program and put back into their company's standard plan.

Harsh as it sounds, it's exactly the type of plan that's likely to catch on as the country debates health-care reform. No matter which of the many proposals knocking around Congress actually passes, there's no doubt companies and their insurers will be expected to hold down the costs of caring for chronically ill people. And diabetes is a doozy: United estimates that newly diagnosed diabetes patients cost payers $12,000 each in their first year. A patient with a complication such as heart disease may cost $30,000 a year. But the biggest potential savings for the employer, according to United, come when you prevent people with "pre-diabetes"—who are also eligible for United's plan—from developing the full-blown illness. "We know if a prediabetic loses 7% of their body weight, the chance they'll become diabetic goes down by 58%," says Dr. Deneen Vojta, vice-president and medical officer at United. "The numbers get astronomic."

$30,000

Annual cost to the health-care system of a diabetes patient who suffers complications. Patients without complications cost a third of that.

Data: UnitedHealthcare

The finances work out well for patients, too. The parameters of the plan differ by employer, but United offers up a hypothetical scenario: Say a company's standard plan charges co-pays of $30 to $50 for prescription drugs; those fees would be waived on medicine diabetes patients use to control their blood sugar and on glucose meters for testing their blood. Deductibles might also be reduced. But patients must agree to twice-yearly physician checkups and other preventive measures, and they have to allow United to keep an online scorecard that uses claims data to keep track of their compliance. United's database technology ensures that the plan is completely secure, so neither the employer nor United gets access to the identities of the employees who participate, unless those patients choose to disclose the information.



GE's Galvin wanted to bring down costs linked to chronically ill patients

CHRIS CASABURI

MEDICATION DISCOUNTS

Although United is the first major insurer to offer a disease-specific plan, other insurance companies offer incentive programs for patients to manage chronic diseases properly. Aetna, for example, has embraced the concept of "value-based insurance design," which is focused on providing medication discounts to patients with



diabetes, high cholesterol, asthma, and other conditions. The hope is that incentives added by Aetna will boost compliance, keep patients healthier, and save money for Aetna's corporate clients. Aetna introduced one such plan, Healthy Actions Rx-Savings, last year, and it was pilot-tested by Marriott International. It's not as extensive as United's offering because it's merely a discount program rather than a comprehensive plan design with strict monitoring. Dr. Edmund Pezalla, Aetna's national medical director for pharmacy management, says it's too early to say if such programs are working, but he's optimistic. "We know people are filling more prescriptions," he says.

United is offering the Diabetes Health Plan only to large companies that are self-insured, meaning the employers bear the entire risk while the insurer administers the plan. What does United gain? For one, it can better compete with its rivals by offering a wider menu of innovative services. More important, the insurer protects itself over the long run: Diabetic patients who don't control the disease could become liabilities down the road, if they change jobs and end up working for a company that's fully insured by United. "Insurers always benefit from healthier members," says Sheryl R. Skolnick, a managing director at Pali Capital who specializes in health care. "It's cheaper to give up co-pays and premiums rather than pay for a diabetic in full-blown distress," regardless of when the patient runs into trouble, she adds.

PRIVACY HURDLES

Plans such as United's haven't always been greeted with applause, however. GE's Galvin says a couple of non-diabetic employees complained that they had more out-of-pocket costs than did those who were eligible for the diabetes plan. And Peter L. Ebb, a partner at the law firm Ropes & Gray, says he was recently hired by a hospital that wanted to implement a plan similar to United's but was getting hassled by its labor union. "Employees were initially suspicious," Ebb says. "They worried, 'Is the information I disclose going to be passed along to my manager? Is there a risk I'm going to get fired?'" Ebb convinced the union that there were enough privacy firewalls built into the program to shield employees' identities, but he suspects similar worries will arise in other workplaces. "This idea can be successful if employers can overcome those concerns," he says.

United is now designing studies that will help it quantify the diabetes plan's impact on health outcomes and expenses. If the insurer can prove the plan reduces costs, it may consider rolling out similar programs for a host of chronic but manageable diseases. Says Vojta: "We can see it moving to other conditions where patient behavior drives outcomes." | BW |

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

Rewarding Good Health Habits

In August the advocacy organization Bipartisan Policy Center released a report called "Improving Quality and Value in the U.S. Health Care System." Among other things, the group recommends that insurers and their corporate customers use "high-performance networks" of hospitals and physicians with proven track records of providing quality, efficient care. And employers should reward workers who pick these preferred providers with discounts on their co-payments. Such programs would also spur providers to invest in efficiency improvements, since "delivering high-value care is more likely to pay off," the group surmises.

For this and related stories, go to
http://bx.businessweek.com/us-healthcare-system/reference/

An Emissions Tariff: Who Would Get Hurt

The measure, now in the Senate, is aimed chiefly at China and India. But would it spark a trade war?

By Steve LeVine

In the early morning of June 26, as Democrats rounded up votes to pass cap-and-trade legislation in the House of Representatives, negotiators settled on a compromise version of an especially controversial section of the bill. Democrats from industrial states demanded a provision allowing tariffs on products from nations with relatively loose standards on greenhouse gas emissions. The idea: If our guys have to spend big money to clean up their U.S. plants, a tariff will level the playing field between them and companies abroad that aren't compelled to spend any money to clean up their mess.

The provision made it to the final bill, which the House passed. Now, Senators John Kerry (D-Mass.) and Lindsey Graham (R-S.C.) are trying to pass a Senate version that includes a tariff. The measure has the backing of utilities such as American Electric Power; U.S. Steel, ArcelorMittal, and other steelmakers; and major cement manufacturers. Many in Congress think the cap-and-trade bill, which would limit overall emissions and create a trading system for pollution credits, won't have the votes to reach President Barack Obama's desk unless it shields U.S. cement, steel, aluminum, and glass factories from unfair competition by dirty plants abroad.

"RECIPE FOR RETALIATION"

Yet Graham is the only Republican on the record as supporting the tariff, and it's not clear how many more in the GOP will eventually back the idea. Senator John McCain (R-Ariz.), for instance, opposes the provision. Even the Obama Administration, which wants cap-and-trade, prefers protecting U.S. industry through global climate-change regulation it will push at a climate-change summit in Copenhagen this December. But Kerry and Graham regard a tariff as a necessary component of a compromise bill that would also attract conservative votes by offering incentives for nuclear power and offshore oil drilling.

One of the opposition's fears is that a trade war could result if a tariff is adopted. "The tariff is playing with fire," says Gary C. Hufbauer, a trade expert at the Peter G. Peterson Institute for International Economics, a Washington think tank. "It's a recipe for a lot of retaliation." Chinese officials have already argued that the tariff violates trade rules. And the Senate proposal comes just as China-U.S. trade spats are multiplying. In September the U.S. slapped a 35% levy on Chinese tires. Beijing responded with a dumping complaint against U.S. chicken parts. Then the United Steelworkers (USW) and three steelmakers filed an antidumping case with the U.S. Commerce Dept. against Chinese makers of coated paper. On Oct. 7, Commerce said it would investigate the possible dumping of Chinese steel pipe. A week later, Beijing announced 37.5%



DAVID POHL

tariffs on a U.S. specialty chemical.

The USW as well as many industry lobbyists and political leaders dismiss the fear that the proposed tariff—which doesn't yet have a specified rate—will escalate trade tensions. "It's bluster," says Senator Sherrod Brown (D-Ohio), who leads a group of 10 Senate Democrats who favor the proposal. Advocates say the tariff's mere existence would likely spur most trading partners to clean up emissions.

COUNTER TARIFFS

Some executives worry about more than a trade face-off. Timothy J. Richards, manager for international energy policy at General Electric, points out that a local company could have a state-of-the-art, low-emissions plant but end up being punished because it's located in a high-polluting country whose exports to the U.S. get hit with the tariff. If a provision for a punitive tariff is included in final legislation, it should be targeted so as "not to hit the good actors," Richards says. "Those that have done what a U.S. firm has done, they should not be hit."

Another problem: Other countries could adopt their own tariffs. "China can say, 'We think this turbine from GE exceeds emissions allowances, because we count SUVs workers drive [to the plant],'" says Hufbauer. "You can see how it could escalate."

Ultimately, some economists argue, a carbon emissions tariff may not even provide the leverage its proponents believe it will. Supporters of the tariff cite the need to protect U.S. industry from heavily polluting rivals in India and China. Those two countries are major polluters, but mostly in the production of goods and services consumed locally. Together they accounted for only 13% of 2007 U.S. imports of aluminum, cement, chemicals, paper, and steel, according to U.S. government figures. By contrast, 53% of America's imports of those products came from fairly clean plants in Canada and the European Union. The Europeans, meanwhile, want to play tough, too. In September, French President Nicolas Sarkozy and German Chancellor Angela Merkel called for a similar tariff to aid EU companies. |BW|



BOOK BUYERS READ BUSINESSWEEK.

Reach an affluent audience who spends $678 million a year on books.

TO PLACE YOUR BOOK AD, CONTACT:

Maryanne Ventrice, Account Manager
212-512-6214, Maryanne_Ventrice@BusinessWeek.com

BusinessWeek

Source: Mendelsohn Affluent Survey 2008



For Entrepreneurs, Credit Eases—a Bit

Lending to small businesses has increased from a drip to a trickle, thanks chiefly to SBA guarantees

By Amy Barrett

SMALL BIZ

A year ago, after Rachel Carson's 12-person company, Helicopter Tech, won a big U.S. Air Force contract, Carson needed a line of credit to hire staff and buy equipment. Her company, in King of Prussia, Pa., supplies spare parts to airplane and helicopter operators. Two banks turned Carson down before she landed a $250,000 Small Business Administration-backed credit line from Susquehanna Bank.

Now things look quite different. In late September, when Carson met with PNC Bank about opening deposit accounts, she was asked if she also wanted to apply for a line of credit. "I was surprised they wanted to explore that with me," Carson says. "A year ago the banks weren't lending to anyone." And in mid-October Carson was cold-called by yet another bank offering her an SBA-backed loan.

Carson and other entrepreneurs are looking to take advantage of a window of opportunity that may be closed by yearend. For entrepreneurs with good balance sheets, credit is beginning to flow again, thanks to increased SBA guarantees on loans, healthier balance sheets at certain banks, and signs the economy is improving. The question

Making money requires a few good moves. In 1959, Amway began as the dream of two friends in Michigan. Today, we operate in 80 countries and territories, and help over 3 million people own their own business. To learn more, contact an Amway Global Independent Business Owner or visit AmwayGlobal.com.

CELEBRATING 50 YEARS

Amway GLOBAL ™





CHRIS CASABURI

Helicopter Tech's Carson is now being courted by banks

is whether the new lending will remain restricted to the strongest companies or pick up steam as the economy stabilizes.

Companies in precarious financial positions are still likely to be frozen out. That's a large swath of small operations: 46% of small business owners surveyed by consulting firm Greenwich Associates in the second quarter said their financial situation had deteriorated during the past 12 months.

But average weekly SBA loan volume is now running about 70% higher than it was in January. "Access to capital is improving," says Eric Zarnikow, associate administrator for the SBA's office of capital access. "But it is still tight, and things are a bit fragile."

Such lending is fueled by money from the Recovery Act, which has allowed the SBA to cut borrowers' fees and raise guarantees. The SBA says the stimulus money will last into December, but Senator Mary Landrieu (D-La.) has said funding may run out sooner. The House Committee on Small Business is crafting a bill to extend Recovery Act provisions for the SBA but may not succeed this year. Tony Wilkinson, president of the National Association of Government Guaranteed Lenders, is urging small business owners to apply for loans sooner rather than later.

A "THAWING"

Even non-SBA-backed loans now may be slightly easier to come by. An October survey by the National Federation of Independent Business found the lending environment had improved slightly since May. And 8 of the top 10 U.S. banks were more willing to lend in the second quarter of 2009 than in the first, according to the Greenwich Associates survey. On Oct. 21, the Obama Administration proposed raising the caps on some SBA loan programs and allowing community banks to tap federal bailout funds if the lenders can show how that money will help them boost loans to small firms.

Michael Selfridge, regional manager for Northern California at Silicon Valley Bank in Santa Clara, Calif., says he now detects a "thawing" in the lending market and has noticed more competition among banks for deals. That's encouraging. But for many entrepreneurs, access to credit is still frozen. |BW|



To take off, you'll need to spread your wings. There's nothing like the freedom to choose your own path and be your own boss. For fifty years, we've been helping people own their own business. If you're ready to get yours off the ground, contact an Amway Global Independent Business Owner or visit AmwayGlobal.com.

CELEBRATING 50 YEARS

Amway GLOBAL ™



Michelin recently won a settlement with Royal Dutch Shell

NICOLAS THIERRY/MAXPPP/LANDOV

STRATEGY & COMPETITION

Europe Inc. Takes Aim At Price-Fixers

Michelin, among others, is using U.S. tactics—and lawyers—to sue supply cartels that overcharge

By Michael Orey

Antitrust cops around the globe have moved aggressively against price fixers in recent years. But while businesses victimized by such actions have long pursued compensation in the U.S., they've rarely done so in Europe. Along with legal barriers on the Continent, a clubby culture makes many executives reluctant to go after suppliers.

That's beginning to change. European countries have made it easier for cartel victims to sue, a trend that has prompted a growing number of U.S. law firms to set up shop in London and Brussels with an eye to pursuing cases. More important, European companies are starting to go after suppliers for compensation. Laurent Geelhand, European general counsel for Michelin Group, says such actions increasingly are viewed as a corporate responsibility. "You need to educate your people that this is the best way to proceed," he says. "We tell them that this is not a declaration of war, but there is a duty to the shareholders to be compensated."

Michelin has hired Dickstein Shapiro, a Washington (D.C.) law firm, to help it recover excess payments to suppliers of chemicals used to make synthetic rubber. The case is being argued in London courts. A defendant, Royal Dutch Shell of the Netherlands, recently settled without admitting liability. The others include Bayer of Germany and Michigan-based Dow Chemical. Both declined to comment. Says Geelhand: "Today, each time we see that some of our suppliers have engaged in cartel activities, we determine if there are grounds to be compensated."

€9.9 billion

Fines imposed by the EC since 2004 on companies found to have participated in cartels

Source: European Commission

Indeed, Michelin has also hired Michael Hausfeld, a veteran plaintiffs' antitrust laywer in the U.S., to explore two other potential price-fixing cases in Europe. He says Volvo and retailer H&M have retained his firm to look into cartel claims. And Washington (D.C.)-based Crowell & Moring is representing a group of German, French, and U.S. manufacturers seeking damages in a London court from companies found by the European Commission to have fixed prices. Morgan Crucible, a supplier of carbon products, is the suit's principal defendant. Having blown the whistle on the cartel, it escaped an EC fine. (It declined to comment.) The plaintiffs include Emerson Electric, Valeo, and Bosch Group. Meanwhile, a Brussels company called Cartel Damage Claims has bought the right to sue from some business victims of price-fixing and is pursuing those cases in German courts. German chemical maker Evonik Industries (formerly Degussa) says it's settling claims in a case involving a hydrogen peroxide cartel.

"I've been warning clients for a number of years that this would happen," says Marc Hansen, an attorney working in London and Brussels whose U.S.-based firm, Latham & Watkins, defends companies in price-fixing cases. The growing number of claims, he says, "has really gotten people's attention."

Even so, the barriers in Europe remain high. There's no tripling of damages, as in the U.S., giving companies less incentive to pursue cases. The fact that business operations are usually spread across different countries raises complex jurisdiction issues. But the biggest obstacle, lawyers say, is the absence in Europe of U.S.-style discovery, the process that gives litigants access to each other's documents and witnesses. Without that, there may be no way to prove a claim. |BW|

STRATEGY & COMPETITION

Why All Eyeballs Are on CBS

The top network proves youth isn't everything by pulling in ad dollars for its slightly graying audience

By Ronald Grover

Everywhere you look these days, network TV executives seem to be shredding their playbooks and experimenting with their programming. The prevailing sentiment seems to be: We'll do whatever it takes to cut costs and keep viewers tuning in. Exhibit A: Jay Leno, who has stepped out from behind his late-night desk to yuck it up on NBC during prime time.

Then there's CBS, where it's same old, same old. Yes, the Tiffany Network has added a Los Angeles spin-off to its military crime show *NCIS*, and launched *The Good Wife*, a ripped-from-the-headlines drama about the lawyer wife of a philandering politician. But mostly CBS is relying on sitcoms and police procedurals—the very definition of Old Media.

How is that working out for CBS? Pretty well, it seems. Three weeks into the fall season, it's on a roll. With 12 shows in Nielsen's top 20, including the top-rated comedy, *Two and a Half Men*, and its most popular drama, *NCIS*, CBS draws an average of 12.4 million prime-time viewers, 2.4 million more than runner-up ABC. Meanwhile, the stock has been handily outperforming those of its peers. "They've proven anyone wrong who thought that no matter what a network did, their audiences would continue to erode," says Andrew Donchin, who works for the media buying agency Carat North America and helps buy ad time on CBS for such companies as Pfizer, Black & Decker, and Papa John's International.

Of course this year's ratings champ can quickly become next year's chump; such is the nature of a hit-driven business. But here's the interesting part: While CBS attracts older viewers than the other networks (its average age is 55 vs. Fox's 44), its ability to attract large audiences is prompting advertisers, long obsessed with viewers aged 18 to 49, to give CBS a second look. Donna Spurrier runs Spurrier Media Group, which places ads for companies. One client, Identity Guard, which helps consumers ward off ID thieves, had a small ad budget and chose CBS because it has large numbers of loyal viewers. "When you have a limited budget, you have to fish where the fish are," she says.

Advertisers still pay a premium to reach the 18-to-49 set, say media buyers like Donchin, "but we're no longer as fixated on that. We look at who gets the eyeballs and who makes the buying decisions in a household." It helps, too, that viewers aged 25 to 54—CBS's strongest demographic—watch 90 minutes more of TV a night than 18- to 49-year-olds, says Brad Adgate, a research executive at the ad buying agency Horizon Media.

Fox can still charge advertisers a hefty premium for shows like *Family Guy* that have built huge followings among young viewers. But CBS's large audiences have helped it to an additional 10% or more for 30-second ads compared to earlier this year. As a result, estimates industry analyst SNL Kagan, CBS will generate $4.7 billion in advertising revenues this year, allowing it to sneak past NBC (table).

For years, CBS CEO Leslie Moonves has called advertisers' fixation on young viewers simplistic. Now, with 18- to 49-year-old Americans among the hardest-hit casualties of the Great Recession, his theory makes more sense. As Moonves told *BusinessWeek* in an interview: "Someone needs to show me where an 18-year-old consumer buys more than a 50-year-old." The question for CBS is whether big audiences of graying Americans will jazz advertisers once the economy recovers. |BW|

HOTTEST AD SALES

	GROSS AD REVENUES (BILLIONS)*
CBS	$4.7
NBC	4.6
ABC	3.8
Fox	2.8

*2009 estimate
Data: SNL Kagan



Moonves thinks the 18-to-49 demographic may be overrated

JOHN SPELLMAN/RETNA LTD.



STRATEGY & COMPETITION

India's Jet Setters Now Prefer Coach

Airlines, struggling with overcapacity, are cutting posh meals and taking out business-class seats

By Mehul Srivastava

DELHI

Air travelers in India gave a collective sigh of relief after Jet Airways, the country's No. 2 private airline, negotiated an end to a five-day pilots' strike in September. Jet's rivals, though, were less pleased. In an industry vexed by too many planes and too few passengers, the strike may have been their most profitable stretch in years.

As soon as Jet—which controls a quarter of the market—started cancelling flights, competitors doubled or even quadrupled fares. "We raked it in," gloats the chief operating officer of a rival, who asked not to be named because India's government frowned on the move. "All the industry needs is for one major airline to go out of business, and the rest of us will be fine."

That would be bitter medicine for a sector that has seen passenger traffic nearly double every two years this decade. They wooed economy fliers with tickets at throwaway prices and wowed business-class travelers with lavish meals, plush lounges, and helicopter rides from airports. "These airlines, they treat you like a king," says Jagdish Chattra, a 52-year-old hotel owner from Dallas. He spent $130 to fly business from Delhi to Mumbai on Kingfisher Airlines, India's largest private carrier. A valet toted his bags, his lunch included spinach-and-brie soup and salmon, and a flight attendant polished his eyeglasses before landing.

You don't need clean spectacles to see the red ink when earnings season comes along. All told, India's carriers have fewer planes than American Airlines. Yet they lost $2 billion in the fiscal year ended March, a fifth of the global total for the industry. Jet Airways had operating losses of $268 million, and Air India, the aging and stodgy state-run carrier, lost more than $1 billion.

$2 billion

Losses by Indian airlines last fiscal year, or 20% of the global industry's total

Data: IATA

The biggest problem is overcapacity. As the economy surged, carriers added planes and destinations in a frantic race for market share. They hoped to hook Indians on air travel and leave profit worries until later. Low-cost carrier IndiGo ordered 100 Airbus A320s, with a total list price of $6 billion. Kingfisher queued up for five double-decker Airbus A380s at $350 million each.

If one big carrier goes out of business, "the rest of us will be fine"

As it turns out, Indians did get addicted to air travel, but only when it's cheap. Airlines flew 8.5% fewer passengers in the first half of 2009 vs. the same period last year as carriers raised prices and customers opted for state-run Indian Railways. A 16-hour train ride from Delhi to Mumbai in an air-conditioned coach can cost as little as $15. "If I can fly for $30 or so, fine," says Agneesh Yadav, a 27-year-old accountant in Delhi. "Otherwise, I take a train and enjoy the scenery."

As the airlines play a game of chicken—no one wants to trim capacity or raise prices if rivals don't—airplane makers are suffering. Jet Airways has cut available seats on major routes as much as 30%, deferring deliveries of two Boeing 777s and five 737s. Air India is in talks to cancel a half-dozen 777s. And Kingfisher has cancelled a $1 billion order for Airbus A340s and deferred deliveries of the A380s and 32 smaller planes.

The posh offerings are also on their way out as airlines take out business-class seats and pack in economy passengers. Jet Airways, for instance, has moved 70% of its traffic to its low-cost arm, called Jet Konnect, by converting some two dozen planes. Ultimately, such moves will mean a smaller industry, at least in revenue. Flying may not be glamorous or include salmon lunches and eyeglass-polishing, but it might just be profitable. |BW|

DANIEL BEREHULAK/GETTY IMAGES

MANAGEMENT & LEADERSHIP

When the Laid-Off Are Better Off

Victims of Boeing layoffs, researchers found, were less depressed and drank less than those who remained

By Michelle Conlin

As the Great Recession continues to devour jobs at an alarming rate, tales are legion about the millions of unemployed struggling to right their lives and recover their self-esteem. But what happens to those left behind?

Would it surprise you to learn that survivors can suffer just as much, if not more, than colleagues who get laid off? It certainly surprised a team of academic researchers who embedded themselves at Boeing from 1996 to 2006, a tumultuous decade during which the company laid off tens of thousands. The results of the study will appear next year in a Yale University Press book called *Turbulence: Boeing and the State of American Workers and Managers*. "How much better off the laid-off were was stunning and shocking to us," says Sarah Moore, a University of Puget Sound industrial psychology professor who is one of the book's four authors. "So much of the literature talks about how dreadful unemployment is."



TOMER HANUKA

"EXECUTIONER'S LAMENT"

By early 1996 the researchers were busy interviewing and testing 3,500 Boeing employees—from line workers to senior executives. The timing was propitious. Struggling to adapt to new technology and competition from Europe's Airbus, Boeing in 1997 merged with McDonnell Douglas. Over the next six years, Boeing's workforce of 234,850 shrunk 33%, to 157,441.

With each round of layoffs, the survivors hustled to reinvent themselves. They re-proved, re-auditioned, and repositioned, only to watch yet another new manager—pushing the fad du jour—parade through the door. Employees who had once seen themselves in every plane that flew overhead were now trading in gallows humor. As in, "Dead worker walking."

Human resources specialist Frank Zemek was the researchers' main contact. In an interview, he recalled "the survivor's guilt of the people who were left, who were waiting and not knowing if the hatchet was going to fall on them. They experienced the worst stress."

As more manufacturing was outsourced, workers said they no longer felt as if they were building planes. They were simply snapping them together. They obsessed about the loss of institutional knowledge. Managers who had fired people, meanwhile, confessed deep, pervasive grief—what researchers sometimes call "executioner's lament." Moore says they tended to become emotionally numb and disengaged.

In the greatest surprise of all, the researchers discovered that the people who had been laid off often were happier than those left behind. Many had new jobs, even if they didn't always pay as well. Over and over, Moore says, average depression scores were nearly twice as great for those who stayed with Boeing vs. those who left. The laid-off were less likely to binge drink, often slept better, and had fewer chronic health problems.

The researchers say that thanks to the unceasing uncertainty inside Boeing, those who left felt as though they had escaped a bad marriage. At the time one Boeing employee told researchers: "You feel better when someone takes their foot off your neck."

Today morale has improved at Boeing, Moore says. Yes, the company's new jet, the 787, is behind schedule. But the high-tech plane has helped revive Boeing's esprit de corp. Since W. James McNerney Jr. became CEO in 2005, engagement scores—which measure worker spirits—have steadily risen, the company says.

And what of the original 3,500 research subjects? Only 525 still work at Boeing. Moore reports that many never regained their equilibrium. When they see her, they say: "Yeah, I still work for Boeing ... this week." |BW|


Windows®. Life without Walls™. Panasonic recommends Windows.
intel Centrino 2 vPro™ inside™
Protect. Manage.
IN YOUR WORLD, BUSINESS NEVER STOPS. NEITHER SHOULD YOUR COMPUTER.
7 TIMES MORE RELIABLE THAN THE INDUSTRY AVERAGE.
For over fifteen years, Panasonic Toughbook® computers have delivered maximum reliability and performance by building ruggedness into every one of our mobile laptops from the inside out—from the shock-mounted hard drives, vibration-resistant LCD screens and spill-resistant designs, to the dependable built-in wireless. No matter how extreme the demands of your job, Toughbook computers powered by Intel® Centrino® 2 with vPro™ technology take care of business.
Learn more: 1.888.223.1184 / panasonic.com/toughbook
TOUGHBOOK®
LAPTOP
EDITORS' CHOICE
BEST NOTEBOOKS OF THE YEAR
Toughbook 30
EPEAT
GOLD
Toughbook U1
TOUGHBOOK
FOR A TOUGHWORLD™
Panasonic ideas for life
Fast, easy, affordable financing available through Panasonic Finance Solutions.
Please call 1.800.662.3537 for details.
Intel, the Intel logo, Centrino, Centrino Inside, Intel vPro and vPro Inside are trademarks of Intel Corporation in the U.S. and other countries. Toughbook notebook PCs are covered by a 3-year limited warranty, parts and labor. To view the full text of the warranty, log on to panasonic.com/business/toughbook/support.asp. Please consult your Panasonic representative prior to purchase. Panasonic is constantly enhancing product specifications and accessories. Specifications subject to change without notice. (*CF-52EV, CF-52GF and CF-52GU, **CF-30K, ***CF-19K, ****CF-F8EW are Intel® Centrino® 2 with vPro™ technology) ©2009 Panasonic Corporation of North America. All rights reserved. NeverStops_H_FY09-2
Toughbook 52* Toughbook 30** Toughbook 19*** Toughbook F8**** Toughbook U1

068 How to Play It: China
069 Investing: When to Roth
070 Life Management: How women handle success
072 Inside Wall Street



PERSONAL BUSINESS



MONEY REPORT

By Ben Levisohn

READING THE DOLLAR

Investors have pulled money from equity funds for seven of the last nine weeks, says research firm EPFR Global. Even so, on Oct. 19 the Standard & Poor's 500-stock index hit a 52-week high. Bank of America Merrill Lynch technical analyst Mary Ann Bartels says to watch the U.S. dollar for clues to when the run is overdone. ¶ Since the financial crisis began, stocks and the dollar have moved in opposite directions. The currency has been falling since Mar. 6, and stocks started rising a few days later. The market is being led by commodity stocks, which benefit from a weakening greenback. (Most commodities are priced in dollars, so when the dollar falls vs. other currencies, commodity prices rise.) The dollar trades at 75.33 against a basket of currencies, its lowest point in over a year, but is nearing a price where technical analysts say buyers may jump in—72. If it holds there, beware. The S&P 500 is also near a technically significant level, 1120, which could bring heavy selling. A stronger dollar could mean a 15% pullback, says Bartels, who advises holding health care, consumer staples, and energy to dampen the blow.

BONDS

COUPON CLIPPERS

After gaining 14% this year (as of Sept. 30), municipal bonds have hit a wall. From the end of September to Oct. 14, muni prices fell 3.8%. Municipalities are struggling, too: On Oct. 13, Washington State cut a debt offering by 36%, and Hawaii delayed its $623.5 million issue the next day in the face of low demand. Investor appetite was being tested further in the week of Oct. 19, with $11.3 billion in offerings expected to come to market. What's going on? Yields had fallen so far—as low as 2.19% on a seven-year AAA-rated bond—that buy-and-hold investors stopped buying, says John Mousseau, a portfolio manager at Cumberland Advisors in Vineland, N.J. So prices fell and yields rose. A seven-year bond now pays 2.66%, up nearly a half percentage point in three weeks. Investors buying now won't see a big price pop, he says: "They'll get more return from coupon income and less from price."

$11.3 billion

Amount of muni issues expected the week of Oct. 19, the most since June

Data: Bloomberg

ILLUSTRATION BY BLAIR KELLY

INDUSTRIALS

VALMONT'S REVERSAL

Valmont Industries' blockbuster quarter—it beat earnings expectations by 47¢—quickly turned into a rout as the company's stock plunged 14% in the two days following its Oct. 15 earnings announcement. Big gains in the metal-products maker's utility unit, which makes steel poles for energy transmission, had led shares to more than double since a February low. But with utilities scaling back, Valmont said growth likely is coming to an end. And other units, which had been counted on to pick up the slack, continue to struggle. Its engineered support unit, which makes streetlights, won't pick up until a federal highway bill is passed, and irrigation sales suffered as unseasonably cool weather forced farmers to delay their harvests.

Still, the pullback in Valmont's shares may be a buying opportunity for long-term investors, says Gabelli analyst Anthony Fritz. "The outlook is still pretty weak," he says. "But in the end, Valmont is still a great company with good management."



THE CHINA HYPE

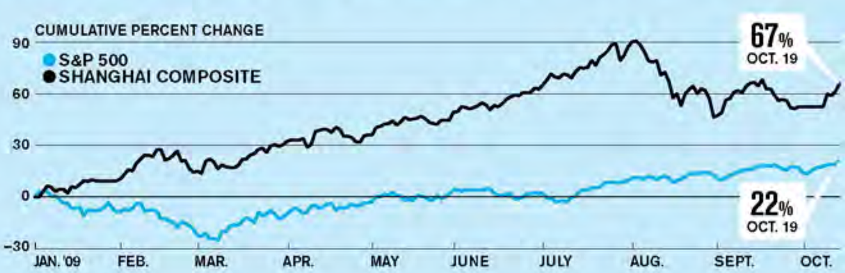
(FROM PAGE 036)

By Lauren Young

China's economy is on track to grow 8% in 2009, but technological innovation isn't likely to drive the expansion. The main engines are expected to be infrastructure development and consumer spending. Investors should stick with big global players, many of which are state-run monopolies—and remember that rapid economic growth may not translate into blockbuster stock gains.

CHINA RISING

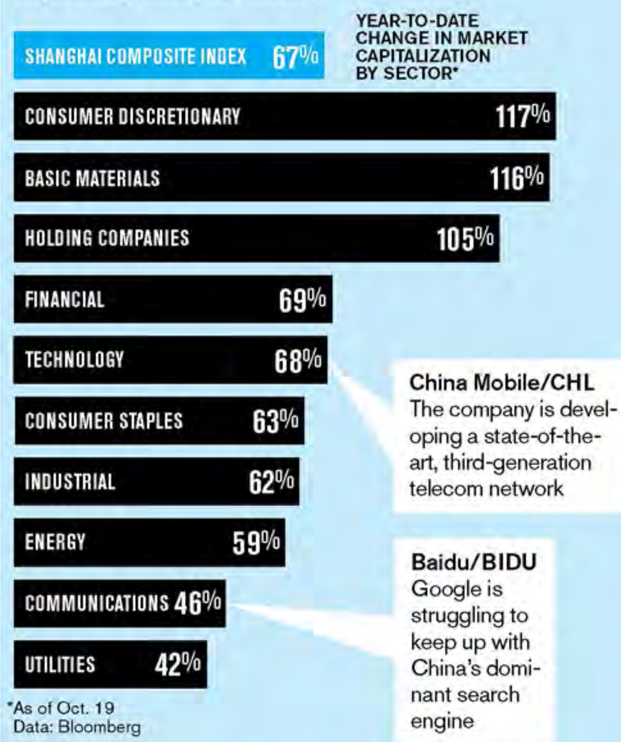
China's benchmark index is beating the S&P 500-stock index this year



Data: Bloomberg

INDUSTRIES ON THE MOVE

Shares of technology and communications companies in the Shanghai Composite haven't been the index's best performers in the past year, but investors can take advantage of pockets of innovation in these two sectors via American depositary receipts (ADRs).



*As of Oct. 19
Data: Bloomberg

BUSINESSWEEK.COM | To comment on How To Play It stories and see related video interviews, go to businessweek.com/go/09/playit

RED CHIPS

These China-centered funds are run by pros who have delivered stellar long-term performance by focusing on companies that have dominated the country's competitive landscape.

FUND/TICKER	TOTAL RETURN* 2009	TOTAL RETURN* THREE YEARS	COMMENT
Guinness Atkinson China & Hong/ ICHKX	85.6%	17.5%	This conservative portfolio offers a mix of prominent construction and real estate stocks, which manager Edmund Harriss says are poised to move when the housing market rebounds.
Matthews China/ MCHFX	71.3	22.6	While most rivals focus on huge companies with a median market cap above $20 billion, this portfolio holds more nimble outfits with an average market cap of $6.5 billion. It's the only China fund with a five-star Morningstar rating.
Templeton China World A/TCWAX	59.0	14.9	Emerging-market guru Mark Mobius has bet big on energy giant China Petroleum & Chemical and on telecom stocks, such as China Mobile. The portfolio is concentrated: The top 10 holdings account for 60% of assets.

*as of Oct. 19; multiyear returns are annualized   Data: Morningstar

SAVINGS

SHOULD YOU ROTH?

By Christopher Farrell

By most accounts the single best retirement savings plan is the Roth IRA. The main reason: Since you've already paid tax on the money going in, you don't have to pay taxes on accumulated gains when you withdraw money during retirement. But strict income limits have prevented highly compensated employees from opening an account. A $100,000 earnings cap on anyone wanting to shift money from a traditional IRA to a Roth also acts as a limit on the well-off.

Most investors know that a Roth conversion gold rush is set to begin in 2010, when the earnings limit on conversions will be lifted. The prospect has financial planners huddling with wealthy clients to figure out whether it pays to dip into IRAs, pay any taxes owed, and turn them into a Roth. Less appreciated is another pot of money available for older workers to convert: their employer-sponsored retirement savings plans.

If you are over 59½ and still working at your company, you can withdraw the money in your employer's 401(k) plan without penalty and place it in a Roth. Your company's pension-plan documentation must allow for such an "in-service" distribution (while you're still employed), and a majority of large companies permit it. "The move can potentially save you a lot in future taxes," says Laurence Kotlikoff, an economist at Boston University and head of Economic Security Planning, a financial advisory firm.

But there's the rub—taxes. As with a conversion from a traditional IRA, you need to pay ordinary income taxes on the withdrawn money. A reasonable rule of thumb is that it's probably worth it if you have additional savings to tap for the tax bill. It does not make sense if you use withdrawn 401(k) money to pay the tax levy, since that reduces the amount that can grow, free of tax, in the Roth. It also probably doesn't make sense if you expect your tax rate to be lower in retirement than it is now.

Joel Larsen, a certified financial planner at Navion Financial Advisors in Davis, Calif., simulated a portfolio for a hypothetical 63-year-old worker in California. Among the more important assumptions in his calculations were a 33% federal and 9% state levy before retirement and a 28% and 4% tax rate afterwards. Larsen also used a 1.9% real rate of return on assets after inflation, a retirement age of 68, a life expectancy of 90, and a 401(k) worth $708,614 at age 68.

NUMBER CRUNCHING

If the 63-year-old leaves his 401(k) alone, he can assume an estimated annual aftertax income of $28,910, without touching the principal. If he converts the account at age 63 and pays the tax from other savings (and subtracts an amount he reckons he might have earned on the money he used to pay taxes), his estimated aftertax income is $29,749. In other words, he should convert. "And I wouldn't stop contributing to the 401(k)," adds Larsen.



ILLUSTRATION BY SOPHIE CASSON

It pays to play with the numbers. If you have only enough savings to pay taxes on a partial withdrawal, for example, you can take out just a portion of the money. The benefits of an in-service withdrawal from a 401(k) to a Roth extend beyond income, too. For one thing, no minimum distribution is required at age 70½ from a Roth like there is from a 401(k). And withdrawals from a Roth aren't counted in adjusted gross income, either. |BW|

LEADERSHIP

HOW WOMEN HANDLE SUCCESS



In his latest book, *Find Your Strongest Life*, best-selling author Marcus Buckingham set his sights on analyzing what the happiest and most successful women have in common. *BusinessWeek* invited Buckingham and several dozen readers to an Oct. 7 breakfast at the midtown Manhattan headquarters of *BusinessWeek* for a



panel discussion with four top female executives. The panelists, all of whom have been successful in managing their own careers while also helping foster a culture of leadership within their companies, were Andrea Wong, CEO of Lifetime Networks; Geralyn Breig, president for North America at Avon Products; Susan Peters, chief learning officer at General Electric; and Billie Williamson, inclusiveness officer for the Americas at Ernst & Young. Here are edited excerpts of their conversation:

MARCUS BUCKINGHAM Geralyn, when you took a job at Godiva in Europe, you had three young kids. What went through your head as you thought about how you were going to handle it?

GERALYN BREIG I was hot to get a general management job, but at Campbell there weren't that many. Doug Conant, CEO of Campbell, had seen me operate and offered me the job of president of Godiva International. The pitch was: "You can continue to live in Connecticut, but your office will be in Belgium, and you'll have other offices in Tokyo and Hong Kong." I sat down with my husband, and we figured we could do anything for a year. Our agreement was if at the end of the year it was hurting the marriage or the family, I'd bail out. We didn't tell the boss that.

BUCKINGHAM Did you ever question the choice?

BREIG Well, I'm going to tell you the dirty little secret about the role. The first year, it was a relief to get a break from three children under 9. When you get into Business Class on a 12-hour flight to Tokyo and people are bringing you drinks and warm nuts, it is not a bad thing. I was able to collect my thoughts and stretch myself personally. The second year, I was able to be more effective, and by the third year I knew it was time to come home.

BUCKINGHAM Andrea, you're leading a company in a town that is well-known for being connected. Talk to us about how you have built the relationships you need to succeed in Hollywood.

ANDREA WONG You have this assumption that if you just put your head down and work, you will be rewarded for it. Relationships are critical, whether it's in your business or across adjacent businesses. They may not directly impact you immediately, but three years or five years later they come into play in some way, shape, or form.

Our panel of high-achieving women included (from top) Susan Peters, Geralyn Breig, Billie Williamson, and Andrea Wong

ILLUSTRATION BY PADDY MILLS



BUCKINGHAM Some people say women today simply face too many domains in life in which they're supposed to excel. Susan, does that square with your experience?

SUSAN PETERS I know you've all done this, where you're writing the list of what you have to get done for Thanksgiving dinner while the colleague next to you is making the big presentation. You have to discipline your mind to stay where you are and stay in the moment. I would argue that our male colleagues are in the moment, and if we're not, that's a huge disadvantage.

BUCKINGHAM There's been a fair amount of research done on multitasking of late, and it turns out that men are not very good at it. It turns out women are terrible, too. When you multitask, your brain is actually concentrating on flitting from one task to another. Your functioning IQ drops 10 points. You're supposed to do things in series. It speaks to finding a balance. Billie, has that been a life goal of yours?

BILLIE WILLIAMSON You probably ought to just throw that word out of your vocabulary, because it doesn't really exist. You have to decide what is most important. My daughter's pictures are not in those nice little scrapbooks. They're in a big old box, and someday I'll get around to those scrapbooks, or I'll give them to her in the box.

Life is made up of stages, so there are times when you focus on your job, and there are times when you have to focus on your family. Overall, they even out. I can pretty much outsource anything except caring for my family. All of my holiday shopping is done on the Internet, generally at 10 or 11 at night. Growing up, you could have eaten off of the floor at my mother's house. Please do not do that at my house. It's hazardous to your health.

BUCKINGHAM When you ask men what they think will help them achieve greater success in life—leveraging their strengths or fixing their weaknesses—men are at 50/50. If you ask women, 27% say "build on my strengths," and 73% say "fix my weaknesses." Women probably spend more time thinking about what they need to fix, and that probably plays into how assertively you walk into a salary negotiation or promotion.

PETERS I have found that when men are going to leave the company, they go in and say: "I've got this other offer," and they really are expecting that there will be a counteroffer. When women decide to resign, they've decided to resign.

BUCKINGHAM What's one piece of advice you would give young women?

BREIG A lot of women are afraid that as they move up and take on more responsibility, it gets harder and harder to have balance. The thing I've learned is, while I have more responsibility, I also have much more control over my schedule.

WILLIAMSON You need to build relationships with the people above you, your peers, and the people who work for you. I knew to build them with the people who worked for me, and I just sort of assumed they would be there with my peers and superiors. But they weren't. You absolutely must take time every day to build relationships with people all around you.

WONG Take time to manage your own career. It is not going to happen for you. Also, my two favorite things to say are "yes" and "thank you." The more that you can use those two words, the better. **|BW|**

MARCUS BUCKINGHAM: MYTHS ABOUT THE LIVES OF WOMEN

1	**With better education, jobs, and pay, women are happier and more fulfilled.**	Surveys of more than 1.3 million men and women reveal that women are less happy compared with 40 years ago, and compared with men.
2	**Children want to spend more time with their working mothers.**	1,000 kids were asked what they wanted from their working moms. 10% said "more time." More than a third wanted mom "less stressed and tired."
3	**Women are relegated to lower-level roles at work.**	In fact, 37% of women hold managerial positions today, vs. 31% of men.
4	**Flexible work options like paid leave allow women to feel happier at work.**	Studies show a negative correlation between taking advantage of such options and a woman's self-reported daily happiness.
5	**Women would prefer to work for other women.**	About 40% of women want to work for men, while 26% prefer a female boss.

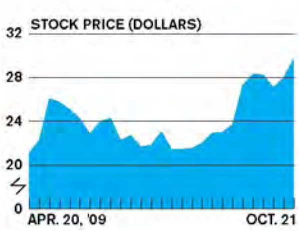
BUSINESSWEEK.COM | **For a book excerpt, and more from women leaders, go to www.businessweek.com/go/09/women_leadership**



LASER-LIKE GROWTH AT FLIR

GARP (growth at a reasonable price). That's what money manager Eddie Brown, who coined the phrase in 1983, and other dedicated growth investors live for. Brown says "the cheapest value" now among growth stocks is Flir Systems (FLIR), No. 1 in infrared technology for various purposes, including military uses.

FLIR SYSTEMS IS CLIMBING



Data: Bloomberg

Flir stock climbed to 29.77 on Oct. 21, up from a 52-week low of 18.81 on Mar. 9. "By most fundamental metrics, Flir outscores its peers," says Brown, president of Brown Capital Management, whose Mid-Cap Fund handily outpaced the broader Russell MidCap index.

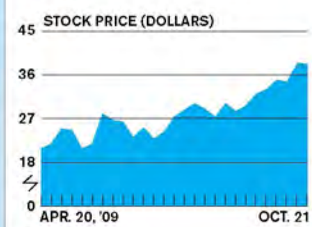
Flir products such as infrared cameras, sensors, and lasers are used by the government (53% of sales) for search and rescue, surveillance, and drug-trade monitoring. Thermal imaging for industrial use accounts for 30%, and commercial security, 17%. Flir's price-earnings ratio of 19 is below its estimated yearly earnings growth rate of 22% over the next three to five years, which means more share-price growth ahead, notes Brown.

Christopher Donaghey of SunTrust Robinson Humphrey, who rates Flir a buy, sees long-term advances "driven by the shift in focus of the U.S. military toward irregular warfare." He sees earnings of $1.43 a share in 2009 and $1.56 in 2010.

BUSINESSWEEK.COM | Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on Thursdays.

Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

BUBBLING UP AT ATWOOD OCEANICS



Data: Bloomberg

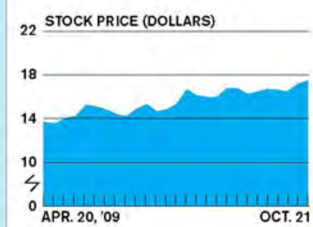
Atwood Sharpens Its Drill Bits

In the oil patch, a compelling growth play is Atwood Oceanics (ATW), which provides offshore drilling services to major oil and gas companies. "Atwood is way underpriced on strong estimated sales and profits over the next two years," says William Rutherford, president of Rutherford Investment Management, which owns shares.

It's poised to benefit from the rise in international offshore drilling as the price of oil surges, he adds. Its stock has been on a tear, bolting to 38.12 on Oct. 21 from a low of 13.49 on Mar. 9. Atwood is currently drilling in the Gulf of Mexico and in countries such as Australia, Thailand, and Turkey.

Lewis Kreps of Jesup & Lamont rates Atwood a buy and sees it hitting 66 in a year. Atwood's fleet of rigs are booked 70% in 2009 and 65%, so far, in 2010. Kreps expects earnings of $3.80 in 2009, $4.15 in 2010, and $5.50 in 2011.

PFIZER: GAINING WITH WYETH?



Data: Bloomberg

A Revitalized Pfizer

Pfizer (PFE), a big laggard last year, has mounted a robust recovery, rising to 17.41 a share on Oct. 21 from 11 in March. The steady progress is partly because the drugmaker is regarded as the "new" Pfizer by some pros who see it gaining from its recent purchase of Wyeth. The combination will revitalize Pfizer's revenues and bring $4 billion in cost synergies, says Herman Saftlas of Standard & Poor's, who rates Pfizer a buy.

According to Bloomberg, 20 of 24 analysts who track Pfizer rate it a buy, and four tag it a hold. The Street's optimism, says Tim Anderson of Sanford C. Bernstein, is due to Pfizer's low valuation, a 3.8% dividend yield that's expected to rise in December, and new products, including one for rheumatoid arthritis. Barbara Ryan of Deutsche Bank, rating Pfizer a buy, foresees earnings of $1.94 in 2009 and $2.34 in 2010. Her 12-month target: 25. |BW|

BRAD TRENT; CHARTS BY RAY VELLA/BW

Pharaohs believed gold could provide eternal wealth. You'll get no argument here.



Ancient civilizations were a primitive and superstitious bunch. But their instincts about gold were second to none. Something beyond its physical beauty told them this was a natural resource with lasting value. Today, the "Metal of Kings" still attracts legions of followers. That's why there's SPDR® Gold Shares, a precise way to access the gold market.

GLD

They let you buy, hold and sell an interest in gold just like a stock. It's simple, cost efficient and fully backed by the real thing. The advantages of gold are timeless. Over the years, it's not only acted as a hedge against inflation. It's helped generations of investors diversify their portfolios. Visit spdrgoldshares.com today. Because while few of us can live like a king, anybody can invest like one.

SPDR®
STATE STREET GLOBAL ADVISORS

Precise in a world that isn't.™

STATE STREET.

gold

The "SPDR" trademark is used under license from The McGraw-Hill Companies, Inc. and the SPDR® Gold Trust is permitted to use the "SPDR" trademark pursuant to a sublicense from the Marketing Agent. No financial product offered by SPDR® Gold Trust, or its affiliates is sponsored, endorsed, sold or promoted by The McGraw-Hill Companies, Inc. ("McGraw-Hill").
McGraw-Hill makes no representation or warranty, express or implied, to the owners of any financial product or any member of the public regarding the advisability of investing in securities generally or in financial products particularly or the ability of the index on which financial products are based to track general stock market performance. McGraw-Hill is not responsible for and has not participated in any determination or calculation made with respect to issuance or redemption of financial products. McGraw-Hill has no obligation or liability in connection with the administration, marketing or trading of financial products. WITHOUT LIMITING ANY OF THE FOREGOING, IN NO EVENT SHALL McGRAW-HILL HAVE ANY LIABILITY FOR ANY SPECIAL, PUNITIVE, INDIRECT, OR CONSEQUENTIAL DAMAGES (INCLUDING, BUT NOT LIMITED TO, LOST PROFITS), EVEN IF NOTIFIED OF THE POSSIBILITY OF SUCH DAMAGES.

LISTED NYSE ARCA.

SPDR® Gold Trust (the "Issuer") has filed a registration statement (including a prospectus) with the SEC for the offering to which this communication relates. Before you invest, you should read the prospectus in that registration statement and other documents the issuer has filed with the SEC for more complete information about the Trust and this offering. You may get these documents for free by visiting EDGAR on the SEC website at www.sec.gov. Alternately, the Trust or any Authorized Participant will arrange to send you the prospectus if you request it by calling toll free at 1-866-320-4053 or contacting State Street Global Markets, LLC, One Lincoln Street, Attn: SPDR Gold Shares, 30th Floor, Boston, MA 02111.

076 Tech & You: A more perfect Storm
078 Feedback: Readers' responses
080 Outside Shot: On political contributions

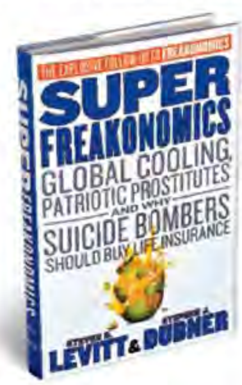
BOOKS | PETER COY

More Oddball Tales for *Freakonomics* Fans

Levitt and Dubner are back with new examples of how incentives make people do the darnedest things

In their second outing, economist Steven D. Levitt and journalist Stephen J. Dubner have gone to even greater lengths to portray themselves as wild and crazy outsiders. While their best-selling 2005 book, *Freakonomics,* had a surreal fruit on the cover (apple outside, orange inside), *SuperFreakonomics* has the same fruit exploding. Their new title evokes Rick James, the outré King of Funk who sang the 1981 hit *Super Freak*. Inside this "freakquel" we find suicide bombers and crash-test dummies, kidneys and foreskins, kangaroo farts, and an anti-global-warming "garden hose to the sky."

But here's the funny thing: The underlying message of *SuperFreakonomics* is not wild and crazy at all. As readers of *Freakonomics* discovered, Levitt and Dubner are true believers in mainstream economics. It is almost a religion with them that incentives matter and people respond to those incentives in predictable ways. The strength of this book, as of the original, is in how it applies the time-tested tools of economics in unusual places to turn up surprising conclusions. For example, the authors discover that some women who have ordinary jobs will matter-of-factly work as prostitutes when the price of such services rises because of a seasonal spike in demand.



SuperFreakonomics: Global Cooling, Patriotic Prostitutes and Why Suicide Bombers Should Buy Life Insurance **by Steven D. Levitt and Stephen J. Dubner; Morrow; 270pp; $29.99**

This application of standard economics to everyday life is inventive, entertaining, and even useful, but it is not, as a cover line promises, "explosive." Gary Becker, 78, the great University of Chicago economist who won a Nobel prize in 1992, has been mining this vein for decades, applying the tools of economics to study the family, drug addiction, and more. Levitt, who is 42, freely acknowledges the debt to his elder. In fact, Levitt directs a center on price theory named after Becker at the University of Chicago's Booth School of Business.

There actually is an explosive new idea in economics, but you won't find much of it in the pages of *SuperFreakonomics*. The new idea is to drag into economics the commonsense observation that people are often short-sighted, emotional, and irrational—even acting against their own best interests. Such things as addiction, procrastination, and spitefulness, which don't fit comfortably into the traditional paradigm of economics, are the meat of this new area of behavioral economics. The controversial yet burgeoning specialty has spawned general-interest books such as *Nudge* by Richard Thaler and Cass Sunstein and *Predictably Irrational* by Dan Ariely.





JIMMY TURRELL

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

Overheated?
SuperFreakonomics' section on climate change has set off a firestorm in the blogosphere. On their own blog, Levitt and Dubner insist they are not "global-warming deniers" and that they intended only to describe possible solutions.

To read the authors' blog, go to **http://bx.businessweek.com/global-climate-change/reference**

It's not as if Levitt and Dubner are unaware of behavioral economics. In 2008, Levitt wrote a rave blurb for *Nudge*, which is by two of his University of Chicago colleagues. He called it "one of the few books I've read recently that fundamentally changes the way I think about the world."

There's not much evidence in *SuperFreakonomics* that behavioral economics has fundamentally changed the way Levitt thinks about the world. He and Dubner still seem wedded to the traditional view that whatever people do must, by definition, be in their own self-perceived best interest. True, there are nods to human fallibility. At one point they write that "knowing and doing are two different things, especially when pleasure is involved." Elsewhere they acknowledge that people's actions are shaped by a "dazzlingly complex" milieu, which would presumably include jealousy, fear, bias, peer pressure, status consciousness, and advertising. But then they assert that people are the captains of their own ships after all: "We act as we do because, given the choices and incentives at play in a particular circumstance, it seems most productive to act that way. This is also known as rational behavior, which is what economics is all about." Those sentences, with their resolute faith in the coherence of human thought, could have been written 50 years ago.

What you do get in *SuperFreakonomics* is many more of the oddball stories that made *Freakonomics* so popular, with more than 4 million copies sold in 35 languages. One provocative section is on the power of cheap and simple fixes for seemingly intractable problems. The "garden hose to the sky," for example, would pump sulfur dioxide into the stratosphere to cool the planet and offset global warming. Former Microsoft Chief Technology Officer Nathan Myhrvold is behind the idea.

BUSINESSWEEK.COM | Meet the author: To watch a video interview with author Steven D. Levitt conducted by *BusinessWeek* Associate Editor Hardy Green, go to businessweek.com/go/09/freakonomics

Overall, the freakquel is a lot like the original, in recognition of a time-tested economic theory: Don't mess with success. One change is that the chapters no longer open with adulatory mini-profiles of the economist co-author, Levitt, by the journalist co-author, Dubner. And this time, Dubner's name appears next to Levitt's on the cover rather than beneath it. That's appropriate because only a small fraction of the stories are based on Levitt's own research.

The authors of *SuperFreakonomics* are not quite as edgy as their publisher makes them out to be. Then again, they don't need to be: The world is full of crazy stuff that standard, off-the-shelf economic tools can help explain perfectly well. |BW|

New from Axios Press
Where Keynes Went Wrong
by Hunter Lewis

"Keynes is demolished and his quack system refuted. Three cheers for Hunter Lewis!"
James Grant
Grant's Interest Rate Observer



RIM's More Perfect Storm

New touchscreen sensors make a huge difference in usability. Still, Apple needn't worry

Over the past few weeks, I have used about a dozen smartphones. The experience has convinced me that touchscreens will soon be the main way we control phones—and that the days of miniature keyboards may well be numbered. This would seem to be bad news for Research In Motion. Even though its keyboard-centric BlackBerrys have gained market share in the face of Apple's iPhone onslaught, those little keys feel very last year. RIM is now demonstrating that it has the problem licked.

The company introduced its first touch model, the Storm, about a year ago, earning strong sales but mixed reviews. (I liked it a lot better than most.) Now, RIM is back with a vastly improved Storm 2, available from Verizon Wireless and Vodafone later this fall.

The Storm 2 appears almost identical to its predecessor. It's a bit shorter and thicker than an iPhone, with a slightly smaller display. The biggest change is in the touch mechanism. The original Storm used a microswitch under the center of the display to respond to each action, such as pressing a key on the virtual keyboard, launching an app, or going to a Web link. The Storm 2 replaces the switch with four sensors at the display's corners. When you tap for an action, you get a tactile click so convincing you will swear the glass has moved, though it hasn't.

This small change produces a huge difference in usability. When typing on the original, you had to lift your finger to release the switch before you could press the next key, which had a nasty effect on the rhythm of typing. The new keyboard feels much more natural, and I found that both my speed and accuracy improved significantly. In addition, the display is now completely sealed around the edges, so pocket lint and other crud can no longer get behind the glass.

Keyboards on smartphones force big compromises—which is one reason



The Storm 2 shows why the mini-keyboard may become a thing of the past

I'm so bullish on touch technology. The traditional BlackBerry "candy bar" design requires displays that are too small. A slide-out keyboard allows a big screen, but whether it is vertical, as on the Palm Pre, or horizontal, as on the new Motorola CLIQ, it results in a poorly balanced and clumsy handset.

Of course, RIM is not abandoning physical keyboards anytime soon. There will be one on the newly updated version of the Bold, another flagship product aimed at professional users. This handset, to be offered by AT&T and T-Mobile in the U.S., is considerably smaller, about the same size as the popular Curve. And in place of the sometimes-finicky trackball, it will get the same touch sensor used on recent Curve models (actually, a miniature camera that follows finger motion.) Look for the same sensor to appear on the Tour, a Bold-like handset RIM is making for Verizon/Sprint.

RIM is reinforcing BlackBerry's strengths, which line up with iPhone's weaknesses: e-mail, battery life, and voice phone

RIM has no illusions that the Storm 2 is an iPhone killer. Instead, the company is reinforcing the BlackBerry's strengths, which line right up with the iPhone's weaknesses: e-mail, battery life, and quality and usability of the voice phone. RIM is also addressing the phone's shortcomings. The Storm 2 includes Wi-Fi, and the browser, while not up to iPhone, Android, or Pre standards, is much improved. A more modern version is in the works.

RIM is well behind the competition in the app wars, but it has just announced new tools to make it easier to write programs that take advantage of BlackBerry features such as contacts. And it's working on a more app-friendly operating system. First, however, it has to deal with the fact that some apps designed for traditional BlackBerrys do not work well, or at all, on the Storm 2's touchscreen.

The latest run of smartphones, from the iPhone 3GS to the Storm 2, shows competition working as it should, improving the breed for all of us. | BW |

BUSINESSWEEK.COM |

For past columns and online-only reviews, go to businessweek.com/go/techmaven.

(TOP) BRAD TRENT

THINK OF IT AS A NAVIGATION SCREEN TO ROI.



Invest in a Multi-Function Printer that works as hard as you do.

In these challenging economic times it's reassuring when office equipment gives you back even more than what you put in. Like Sharp's stylish Multi-Function Printers with a big 8.5" color LCD with touch screen navigation, you can now easily manage document workflow, find stored files, and work smarter than ever before. Plus, Sharp OSA® Technology enables you to seamlessly access anything on your network right from the LCD panel. The Sharp Frontier Series delivers more functionality, efficiency, and productivity in a smaller footprint than anything else in the category. So why are you still using printers, when you can step up to a Frontier? To learn more, visit sharpusa.com/documents



WORK WITHOUT LIMITS

ENERGY STAR

OSA Sharp Open Systems Architecture

2009 Most Reliable MFP
Industry Analysts, Inc. 2009

SHARP®

Sharp and Sharp OSA are trademarks or registered trademarks of Sharp Corporation. All other trademarks are trademarks or registered trademarks of their respective owners. © 2009 Sharp Electronics Corporation. All rights reserved.

078 FEEDBACK

How to reach *BusinessWeek*

LETTERS FOR FEEDBACK
We prefer to receive letters via e-mail, without attachments. Writers should disclose any connection or relationship with the subject of their comments. All letters must include an address and daytime and evening phone numbers. We reserve the right to edit letters for clarity and space and to use them in all electronic and print editions. E-mail: bwreader@businessweek.com Fax: (212) 512-6458

BUSINESSWEEK.COM
The full texts of *BusinessWeek* and *BusinessWeek* Top News, as well as *BusinessWeek* archives starting in 1991, are available on the Web at businessweek.com and on America Online at keyword BW

YOUTH UNEMPLOYMENT
NO GUMPTION—OR NO CHANCE?

You can't write about the problem of youth unemployment, as we did in "The Lost Generation" (Cover Story, Oct. 19), without reigniting what seems to be a smoldering conflict between young and old. In responses to the article, boomers blamed a spoiled Gen Y, while the jobless young slammed their elders for leaving the economy in such a mess. Mostly, though, we heard from young people who are, as our article said, bright, eager—and unwanted. *–Peter Coy*

I have no sympathy for those in a lost generation that have had everything handed to them on a platter and [now] have to start a job...and work their way up. What about the generation of 40- to 60-year-olds who have had their retirement funds wiped out and [are] facing a jobless recovery? The young have years to work in the job market... to make up the loss.

Oh, by the way, many in the older generation have MBAs, too, and can't find jobs.

Screen name: Silicon Valley MBA Jobless Older Generation



I'm sick and tired of people calling my generation the "entitlement" generation, saying we're lazy and asking for a handout. The baby boomers sat by idly while [the U.S.] rang up massive amounts of debt.

Screen name: Mike Wainwright

I have a chemistry PhD from a top 10 school and can't even get an interview for a lab tech job paying $10 an hour. I'm told I'm overeducated and underqualified.

Screen name: Carly

I graduated from my university at the top of my class [and] had two internships while in school, one at a top-tier ad agency. I have had one job offer at a barbell company for $22,000 to do menial work (with a three-hour commute each day). With the climate right now, I almost wish I had taken that position.

Screen name: Amanda

When I tell people I am unemployed, the first question out of their mouths is: "How hard are you really trying to get a job?" I have been turned down for jobs I had when I was 16. It's degrading.

Screen name: Ariana

HOUSING
HOW GOVERNMENT COULD HELP HOMEOWNERS

Regarding "Return of the Mortgage Cramdown?" (What's Next, Oct. 19): The government should offer struggling homeowners, say, 15% of a house's current value in exchange for a share of the profits on a future sale of the house. Or it could finance home-improvement projects in exchange for a share of future profits. This would create demand for labor and energy-efficiency upgrades.

Roger Knights
SEATTLE

H-1B VISAS
GUEST WORKERS AREN'T THE ONLY ONES SUFFERING

Many U.S. citizens are suffering right now trying to find jobs, and many U.S. companies are trying to make a bigger buck on the backs of people who did not contribute to those bottom lines. ("America's High-Tech Sweatshops" Cover Story, Oct. 12). While I understand the frustration of many H-1Bers, understand ours.

Screen name: Tinsoldier

ECONOMICS
KEYNES' RECIPE FOR ADDICTION

When *BusinessWeek* begins endorsing Keynesian economics, praising two new pro-Keynes books, all hope is lost ("The Redemption of Keynes," Books, Sept. 28).

Once we require "full employment" as the bedrock of our thinking, the economy will never be more than a junkie's perpetual search for his pusher. Keynes looked to government manipulation and stimulation of the economy, which leads not to economic health but to an escalating addiction.

John Kleiner
MORAGA, CALIF.

CORRECTIONS & CLARIFICATIONS

"For the Downturn, Gucci Downplays the Logos" (In Depth, Oct. 26) mistakenly attributed Gucci's sales numbers to Bain & Co. Gucci provided the figures. Overall industry data came from Bain.

"A Break From That First Commercial Break" (BTW, Oct. 12), about ABC running fewer ads in initial episodes of some of its new shows, mistakenly said the network might continue the practice into the fall season if ratings and advertiser responses are good. ABC says it is not considering such a move.

RODRIGO CORRAL

COMPANY INDEX

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names.
Companies listed only in tables are not included.

A ABC (DIS) 63
Abraaj Capital 50
Abu Dhabi Investment 50
ACT Research 34
AEP (AEP) 58
Aetna (AET) 56
Airbus 36, 64, 65
Air India 64
Amazon (AMZN) 26, 45, 54
AOL (TWX) 54
A123 Systems 54
Apple (AAPL) 8, 44, 45, 47, 49, 76
ArcelorMittal (MT) 58
Arista Networks 54
AT&T (T) 76
Atwood Oceanics (ATW) 72
Audit Integrity 26
Avon (AVP) 70
B Banamex 8
Barclays (BCS) 50
Bayer 62
Behind the Numbers 26
Black & Decker (BDK) 63
Bloom Energy 54
Boeing (BA) 8, 36, 64, 65
Bosch Group 62
Brigantine Advisors 26
Brown Capital 72
BYD Auto 36
C Calera 54
Campbell Soup (CPB) 70
Carat North America 63
Caris 26
Cartel Damage Claims 62
CBS (CBS) 63
Cerent (CSCO) 54
Chery 36
China Investment 50
CIT Group (CIT) 8
Citigroup (C) 8, 40
CNBC 19
Comac 36
Concept Capital 22
Credit Suisse (CS) 8
CSM Worldwide 34, 36
Cumberland Advisors 67
D Daimler (DAI) 34
DDB Stockholm 16
Deloitte 22, 26, 36
Deutsche Bank (DB) 72
Devotion 36
Dow Chemical (DOW) 62
Dubai Aluminum 50
Dubai Ports World 50
E eBay (EBAY) 45, 48
EcoMotors 54
EFG-Hermes 50
Electronic Arts (ERTS) 45
Emaar Properties 50
Emerson Electric (EMR) 62
Emirates Airlines 50
EPFR Global 67
Ernst & Young 70
Etihad Airways 50
Evolvence Capital 50
Evonik Industries 62
F Facebook 45, 48
Fidelity Investments 40
First Solar (FSLR) 26
Fisker Automotive 54
Flir Systems (FLIR) 72
Ford (F) 30, 36
Foundation Capital 54
Fox (NWS) 63
G Galleon Group 8, 25
Gannett (GCI) 26
Gartner (IT) 28
GE (GE) 56, 58, 70
Geely 36
Genentech (DNA) 54
General Motors 8, 16, 30
Goldman Sachs (GS) 19
Google (GOOG) 8, 44, 45, 47, 49, 54
Gradient Analytics 26
Great Point Energy 54
Greenwich Associates 60
Guinness Atkinson (ICHKX) 68
H H&M 62
Helicopter Tech 60
Hewlett-Packard (HPQ) 36
Honeywell (HON) 36
Horizon Media 63
HSBC (HBC) 50
Huron Consulting (HURN) 26
Hynix Semiconductor 28
I IBM (IBM) 8
Identity Guard 63
IHS Global Insight 34
Indian Railways 64
IndiGo 64
Intel (INTC) 8, 28
Irdeto 32
ISI Group 22
iSuppli 28, 36
J Jefferies (JEF) 54
Jesup & Lamont 72
Jet Airways 64
Jones Lang LaSalle (JLL) 16
JPMorgan Chase (JPM) 19, 30
Juniper Networks (JNPR) 54
K Khosla Ventures 54
Kingfisher Airlines 64
Kleiner Perkins 49, 54
L Leerink Swann 22
Lifetime Networks 70
Linear Technology (LLTC) 28
M Magma Energy 54
Magna International (MGA) 8
Marriott (MAR) 56
Matthews China (MCHFX) 68
McGraw-Hill (MHP) 16, 70
McKinsey 8
Medtronic (MDT) 22
Merrill Lynch (BAC) 67
Michelin Group 62
Microsoft (MSFT) 16, 28, 44, 47, 74
Miller Buckfire 16
Minolta 40
Mint.com 48
Moody's (MCO) 26
Morgan Crucible 62
Morgan Stanley (MS) 36
Motorola (MOT) 76
N Navion Financial 69
NBC 63
Nielsen 63
Nissan (NSANY) 34
Nokia (NOK) 28, 36, 44
NTT (NTT) 40
O Oracle (ORCL) 40, 44
O'Reilly AlphaTech 49
P Pali Capital 56
Palm (PALM) 76
Papa John's (PZZA) 63
Pfizer (PFE) 63, 72
Playdom 45
Playfish 45
PNC Bank (PNC) 60
Pratt & Whitney 36
PwC 26, 54
R RBC Venture Partners 49
RIM (RIMM) 44, 47, 49, 76
Ripplewood Holdings 16
Rockwell Collins (COL) 36
Royal Dutch Shell (RDS) 62
Rutherford Investment 72
S Salesforce.com (CRM) 44
Samsung 36
SanDisk (SNDK) 8
S&P (MHP) 16, 50, 67, 72, 80
Sanford C. Bernstein (AB) 72
Sberbank 8
Silicon Valley Bank 60
Silver Spring Networks 54
Smule 44
SNL Kagan 63
Social Gaming 47
SoftTech VC 49
Sohu.com 32
Soladigm 54
Sprint Nextel (S) 76
Spurrier Media 63
State Street Bank (STT) 8
Strategas Research 22
Sun (JAVA) 54
SunTrust Robinson Humphrey 72
Susquehanna Bank (SUSQ) 60
T Tapulous 49
Templeton China (TCWAX) 68
ThinkEquity Partners 45
Thomson Reuters (TRI) 49
TicketMaster (TKTM) 26
T-Mobile (DT) 76
Toyota (TM) 34, 36
Toys 'R' Us 16
Tudou.com 32
Twitter 48
U Union Square Ventures 49
UnitedHealthcare (UNH) 56
U.S. Bancorp (USB) 8
U.S. Steel (X) 58
V Valeo 62
Valmont Industries (VMI) 67
Verizon (VZ) 49, 76
Virgin Media (VMED) 26
Vodafone (VOD) 76
Volkswagen (VLKAY) 16, 36
Volvo 62
W Wells Fargo (WFC) 8
X XG Ventures 49
Y Yahoo! (YHOO) 8, 48
Youku.com 32
Z Zynga 44, 45

BusinessWeek (USPS 080 900)
NOVEMBER 2, 2009 (ISSN 0007-7135) S T Q ISSUE NO. 4153
Published weekly, except for one issue in January, February, March, July and August by The McGraw-Hill Companies, Inc. **Founder:** James H. McGraw (1860-1948). Periodicals postage paid at New York, N.Y., and at additional mailing offices.
Executive, Editorial, Circulation, and Advertising Offices: The McGraw-Hill Companies Building, 1221 Avenue of the Americas, New York, N.Y. 10020. Telephone: 212-512-2000.
Postmaster: Send address changes to BusinessWeek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 40012501. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit 4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com
Registered for GST as The McGraw-Hill Companies, Inc. GST #R123075673.

Copyright 2009 by The McGraw-Hill Companies, Inc. All rights reserved.

Title registered in U.S. Patent Office. European Circulation Office, McGraw-Hill House, Shoppenhangers Road, Maidenhead, Berks SL6 2QL, England. Telephone: +44 (0) 1628 502900; Fax: +44 (0) 1628 630545.
Officers of The McGraw-Hill Companies, Inc.: Harold W. McGraw III, Chairman, President, and Chief Executive Officer; Kenneth M. Vittor, Executive Vice President and General Counsel; Robert J. Bahash, Executive Vice President and Chief Financial Officer; Elizabeth O'Melia, Senior Vice President, Treasury Operations.
Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com.
Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm
Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com.
Custom Reprints: For customized bulk reprints of BusinessWeek articles, contact The YGS Group at 800-360-5549 or email: businessweekreprints@theYGSgroup.com.
PRINTED IN THE U.S.A.



Ease the pair
Get back to li
with THD!

What is THD?
• An outstanding innovatio
performed worldwide
• A minimally invasive
procedure, less traumatic
less painful treatment for
hemorrhoids

Benefits of THD
• Clinically proven, safe &
effective, with minimal
postoperative pain
• Outpatient procedure, m
patients return home on
hours after procedure
• Back to normal activities
faster, often within 24-48
hours
• THD treats the blood sup
to the hemorrhoids with
removing any tissue

THD

To find a THD physician near y
please visit www.thdamerica.c
or call 866/374-9442

International inquiries please
www.thdlab.com



Spending on Politics? Tell Shareholders

Investors should have a right to approve companies' campaign contributions

On Sept. 9, about a month before the U.S. Supreme Court officially kicked off its 2009-2010 term, the justices assembled to rehear a closely watched case about corporate campaign spending. *Citizens United v. Federal Election Commission* involves a nonprofit group that wanted to use corporate funding to distribute a film harshly critical of Hillary Clinton shortly before the 2008 Presidential primaries.

The 2002 McCain-Feingold Act bars companies from spending their treasury funds on electioneering communications, a prohibition upheld by the court in 2003. Instead, companies must use corporate PACs, segregated funds that are raised—with restrictions—from top executives and others. Thus the FEC argued it was within its rights to bar Citizens United from distributing the anti-Clinton film so close to primary elections. (My employer, the Brennan Center for Justice, submitted a brief backing the FEC.)



But during September's oral argument, the court indicated it may look past the facts of this case and issue a broad ruling—perhaps citing companies' First Amendment rights—that would strike down this McCain-Feingold provision, as well as federal-style campaign finance laws in 22 states that also ban the use of corporate treasury funds to back or oppose candidates in elections. Indeed, the court appears poised to sweep away decades of laws limiting corporate campaign expenditures.

If that happens, U.S. securities laws should be rewritten to protect shareholder interests. For that matter, there's enough corporate treasury money making its way into politics under current law—mostly at the state level—to justify such legislation now.

Shareholders need to be protected because they don't necessarily profit from a corporation's political donations. Indeed, a recent study of more than 12,000 companies, led by University of Minnesota professors Rajesh Aggarwal, Felix Meschke, and Tracy Wang, found that corporate political expenditures were typically linked with lower shareholder value. The survey suggested that donations were based in part on managers' political preferences, not on what might benefit their businesses.

What might a shareholder protection law look like? It could be modeled on the British approach. A law passed in 2000 requires British companies to get shareholders' permission to make political expenditures and must report the spending in their annual reports.

Here's how it works: Corporations annually disclose every political expenditure of at least $3,000, naming the recipients. They must obtain prior shareholder approval, usually at the annual meeting, to spend more than $8,000 on political campaigns in the following year or so (no recipient names required). If the resolution fails, no dice. Any directors who make unapproved corporate donations are personally liable for the amount spent.

By contrast, U.S. shareholders typically don't know how much a company takes from its coffers to spend in elections. In the 28 states lacking federal-style election rules, businesses can donate directly from their treasuries. Such spending can hide in the gaps between campaign finance law and financial regulatory requirements. (The Securities & Exchange Commission doesn't require political contributions to be disclosed in annual reports.) And while most corporate spending on state elections technically must be reported to state regulators, the laws governing this requirement tend to be porous.

There's been some movement toward transparent and accountable corporate political giving, led mostly by the Center for Political Accountability. As of mid-October, at least 66 companies—45 of them in the Standard & Poor's 100—had announced they will disclose their campaign spending. A good start, but given the thousands of publicly listed corporations in the U.S., not enough. Besides, disclosure is just one step. Shareholder approval is equally important. What good is it for investors to object, or disinvest, once the money is out the door?

A U.S. law based on the British model makes sense, even if the Citizens United case doesn't open the floodgates of corporate spending in elections. As the Supreme Court wrote in a 1948 opinion upholding Taft-Hartley rules barring certain political expenditures: "Corporate officials [have] no moral right to use corporate funds for contribution to political parties without the consent of the stockholders." Congress should ensure that they have no legal right, either. |BW|

Ciara Torres-Spelliscy is counsel at the Brennan Center for Justice at NYU School of Law.

ILLUSTRATION BY JESSE LEFKOWITZ



NOW IS PIVOTAL.

Years from now you might look back and recognize now as the exact moment you should've opened a Scottrade account. **Call 1-800-619-7283**, stop by your local branch office or visit **scottrade.com**.

Scottrade®

ONLINE $7 TRADES*

*Online market and limit stock trades are just $7 for stocks priced $1 and above.

Member FINRA/SIPC

Over 60% of the Fortune 100 have gone Google.

"Going Google" means switching your company over to one of Google's enterprise products — from Google Apps to Postini to the Google Search Appliance. Learn more at www.google.com/gonegoogle.

Statistic based on Google enterprise customers listed in the top 100 of the 2009 "Fortune 500," Fortune.
© 2009 Google Inc. All rights reserved. Google and Google logo are trademarks of Google Inc. All other company and product names may be trademarks of the companies with which they are associated.

Google